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No.

Supreme Court, U.S.
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In The

Supreme Court of the United States

OCTOBER TERM, 1980

ROCHESTER GAS AND ELECTRIC CORPORATION,
Appellant,

v.

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
Appellee.

On Appeal From The Court Of Appeals Of The State Of New York

JURISDICTIONAL STATEMENT

RICHARD NEILL GEORGE
Nixon, Hargrave, Devans & Doyle
Lincoln First Tower
Rochester, New York 14603
Telephone: (716) 546-8000

Attorney for Appellant

Of Counsel:
ROBERT L. DAILEADER, JR.

January, 1981

QUESTIONS PRESENTED

This appeal presents the following questions:

(1) Whether a regulatory agency's refusal to provide for the expense of communicating with customers in the setting of a public utility's rates constitutes a limitation upon the utility's right of free speech, regardless of whether such limitation is permissible or impermissible;

(2) Whether a regulatory agency, to sustain its limitation upon a public utility's right of free speech, bears the burden of proving, by a clear and compelling showing, that its limitation is necessary and no greater than necessary; and

(3) Whether due process requires that, in setting the rates of a public utility, the determination of a regulatory agency on a contested issue be supported by substantial evidence in the record of the proceeding in which the determination is made.

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JURISDICTIONAL STATEMENT

Rochester Gas and Electric Corporation appeals from the final judgment of the Court of Appeals of the State of New York, entered October 14, 1980, which affirmed the judgment of the Appellate Division of the New York Supreme Court, Third Department, and which upheld the federal constitutionality of the New York Public Service Law as construed and applied by the Public Service Commission of the State of New York in its orders of November 1, 1976 and January 20, 1978. In those orders setting appellant's rates for electric and gas service, the commission disallowed the major portion of appellant's expenses incurred for its communications with customers, without applying the standards required by the First Amendment for limitations of the right of free speech and without a record evidentiary basis as required by due process of law under the Fourteenth Amendment.

OPINIONS BELOW

The opinion of the Court of Appeals of the State of New York is reported at 51 N.Y.2d 823, and is appended hereto as Appendix A. The opinion of Appellate Division of the Supreme Court of the State of New York, Third Department, is reported at 64 A.D.2d 345, 410 N.Y.S.2d 142, and is appended hereto as Appendix E. The Order Granting In Part And Denying In Part Petition For Rehearing of the Public Service Commission of the State of New York is reported at 18 NY PSC 222, and is appended hereto as Appendix G. The Opinion and Order Determining Revenue Requirement of the Public Service Commission of the State of New York is reported at 17 NY PSC 820, and is appended hereto as Appendix H.

JURISDICTION

Rochester Gas and Electric Corporation ("Rochester"), a regulated public utility, filed with the Public Service Commission of the State of New York ("commission") proposed changes in its electric and gas rates, pursuant to section 66(12) of the New York Public Service Law. Following public evidentiary hearings, briefing, a recommended decision by an administrative law judge, and briefs on exceptions, the commission, acting pursuant to the same statutory section, issued its order setting revised rates for Rochester. In setting those rates the commission disallowed the major portion of Rochester's actual, test period expenses incurred for the purpose of communicating with its customers. By Order issued in response to Rochester's application for rehearing, the commission rejected Rochester's claims that its disallowance was contrary to both Rochester's right of free speech and its right to due process of law.

Rochester commenced this action for review of the commission's action under Article 78 of the New York Civil Practice Law and Rules in New York Supreme Court, Albany County. Following transfer of the action to the Appellate Division of the New York Supreme Court, Third Department, the determination of the commission was sustained, the court rejecting

arguments that the commission's action violates Rochester's rights of both free speech and due process. Following appeal to the New York Court of Appeals, that court also sustained the commission's determination, rejecting the same constitutional claims.

The judgment of the New York Court of Appeals, from which this appeal is taken, was entered on October 14, 1980. Rochester's notice of appeal to this Court was filed with the New York Court of Appeals on December 15, 1980 and with the New York Supreme Court, Albany County, on December 16, 1980.

Jurisdiction of this appeal to review the judgment of the New York Court of Appeals is conferred upon this Court by 28 U.S.C. §1257(2). The following cases sustain this Court's jurisdiction: *Williams v. Bruffy*, 96 U.S. 176, 183 (1878); *Lake Erie & Western R.R. v. State Public Utilities Comm'n ex rel. Cameron*, 249 U.S. 422, 424 (1919); *Corn Products Refining Co. v. Eddy*, 249 U.S. 427, 437 (1919).

CONSTITUTIONAL PROVISIONS, STATUTES, AND ORDERS INVOLVED

First Amendment, United States Constitution:

> Congress shall make no law . . . abridging the freedom of speech . . .

Fourteenth Amendment, United States Constitution:

> No state shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law . . .

Section 66(12), New York Public Service Law (McKinney Supp. 1980):

> The commission shall:
>
> Have power to require every gas corporation, electric corporation and municipality hereinafter in this subdivision called a utility to file with the commission and to print and keep open to public inspection schedules

showing all rates and charges made, established or enforced or to be charged or enforced, all forms of contract or agreement and all rules and regulations relating to rates, charges or service used or to be used, and all general privileges and facilities granted or allowed by such utility; but this subdivision shall not apply to state, municipal or federal contracts, except to the extent such contracts relate to transportation of electricity. No change shall be made in any rate or charge, or in any form of contract or agreement or any rule or regulation relating to any rate, charge or service, or in any general privilege or facility, which shall have been filed by a utility in compliance with an order of the commission, except after thirty days' notice to the commission and to each county, city, town and village served by such utility which had filed with such utility, within the prior twelve months, a request for such notice and which shall be affected by such change and publication of a notice to the public of such proposed change once in each week for four successive weeks in a newspaper having general circulation in each county containing territory affected by the proposed change, which notice shall plainly state the changes proposed and when the change will go into effect. The commission for good cause shown may, except in the case of major changes, allow changes to take effect prior to the end of such thirty-day period and without publication of notice to the public under such conditions as it may prescribe. For the purpose of this subdivision, "major changes" shall mean an increase in the rates and charges which would increase the aggregate revenues of the applicant more than the greater of one hundred thousand dollars or two and one-half percent, but shall not include changes in rates, charges or rentals allowed to go into effect by the commission or made by the utility pursuant to an order of the commission after hearings held upon notice to the public. No utility shall charge, demand, collect or receive a greater or less or different compensation for any service rendered or to be rendered than the rates and charges specified in its schedule filed and in effect; nor shall any utility refund or remit in any manner or by any device any portion of the rates or charges so specified, nor extend to any person any form of contract or agreement, or any rule or regulation, or any

privilege or facility, except such as are regularly and uniformly extended to all persons under like circumstances. The commission shall have power to prescribe the form of every such schedule, and from time to time prescribe by order such changes in the form thereof as may be deemed wise. The commission shall also have power to establish such rules and regulations to carry into effect this subdivision as it may deem necessary, and to modify or amend such rules or regulations from time to time. Nothing in this chapter shall be taken to prohibit a utility from establishing sliding scale upward rates, beginning at a fixed price per unit for a small consumption and then increasing the price per unit as the consumption is increased. Whenever there shall be filed with the commission by any utility any schedule stating a new rate or charge, or any change in any form of contract or agreement or any rule or regulation relating to any rate, charge or service, or in any general privilege or facility, the commission may, at any time within sixty days from the date when such schedule would or has become effective, either upon complaint or upon its own initiative, and, if it so orders, without answer or other formal pleading by the utility, but upon reasonable notice, hold a hearing concerning the propriety of such change, provided that if such change is a major change, the commission shall hold such a hearing; and pending such hearing and decision thereon, the commission, upon filing with such schedule and delivering to the utility, a statement in writing of its reasons therefor, may suspend the operation of such schedule, but not for a longer period than one hundred and twenty days beyond the time when it would otherwise go into effect; and after full hearing, whether completed before or after it goes into effect, the commission may make such order in reference thereto as would be proper in a proceeding begun after the rate, charge, form of contract or agreement, rule, regulation, service, general privilege or facility had become effective. Provided that, if any such hearing cannot be concluded within the period of suspension as above stated, the commission may extend the suspension for a further period, not exceeding six months. The commission shall review all filings to determine if they are in compliance

with section seventy-two-a of this chapter. The commission shall have the power to hold public hearings concerning the propriety of any increased rate of charge for fuel costs, at any hearing involving such an increase, the burden of proof as to the correctness and reasonableness of the charge shall be upon the utility. The commission may, as authorized by section seventy-two establish temporary rates or charges for any period of suspension under this section. At any hearing involving a rate, the burden of proof to show that the change or proposed change if proposed by the utility, or that the existing rate, if it is proposed to reduce the rate, is just and reasonable shall be upon the utility; and the commission may give to the hearing and decision of such questions preference over all other questions pending before it. The schedule, rates, charges, form of contract or agreement, rule, regulation, service, general privilege or facility in force when the new schedule, rate, charge, form of contract, rule, regulation, service, general privilege or facility was filed shall continue in force during the period of the suspension unless the commission shall establish a temporary rate or charge as authorized by section seventy-two.

The Order of the Commission on rehearing is found at 18 NY PSC 222 (1978), and is set forth in Appendix G hereto; the portion thereof which is relevant to this appeal is at pages 35a-37a.

The Order of the Commission determining revenue requirement is found at 17 NY PSC 820 (1977), and is set forth in Appendix H hereto; the portion thereof which is relevant to this appeal is at pages 61a-63a.

STATEMENT OF THE CASE

Rochester filed proposed changes in its electric and gas rates with the commission on December 3, 1976. Accompanying that filing was Rochester's direct evidence in support of its proposed rate increases consisting of the prepared testimony and exhibits of its witnesses, as required by the regulations of the commission. Included in the expenses claimed by Rochester for rate setting were its actual 1976 informational advertising expenses

of approximately $780,000. None of the expenditures involved either promotional or political advertising. By orders dated December 21, 1976 and April 26, 1977 the commission suspended the effectiveness of the proposed rates to November 2, 1977 and embarked upon public hearings before an administrative law judge, as provided for in section 66(12) of the New York Public Service Law.

In March of 1977 public hearings were held for cross-examination of Rochester's witnesses. Thereafter prepared testimony and exhibits of commission staff and intervenors were filed and were subsequently cross-examined by Rochester and other parties during public hearing in April of 1977. On the issue involved in this appeal, only three witnesses purported to present evidence. A commission staff witness proposed to reduce Rochester's communication expenses for rate setting purposes solely on the basis of the *Statement of Policy on Advertising and Promotional Practices of Public Utilities* which the commission had issued on February 25, 1977.[1] (Appendix N-1, pp. 204a-210a.) Two witnesses for an intervenor group protested provision for any communication expenses, but one of them advocated a small allowance for specified types of communication without explaining the derivation of the amount advocated. (Appendices N-2 and N-3, pp. 211a-216a.) Subsequently, Rochester filed rebuttal evidence which was subjected to cross-examination at public hearings during May. Included therein was the testimony of a vice president regarding its communication expenses, which no party chose to cross-examine. (Appendix N-4, pp. 217a-233a.)

Thereafter, in briefs submitted to the administrative law judge, Rochester argued that disallowance of its communication expenses would be in violation of its right of free speech and without evidentiary support. In his recommended decision,

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[1]Two other aspects of this Statement of Policy have been before this Court. *Consolidated Edison Co. of New York, Inc. v. Public Service Comm'n.*, ____ U.S. ____, 65 L.Ed.2d 319 (1980); *Central Hudson Gas & Electric Corp. v. Public Service Comm'n.*, ____ U.S. ____, 65 L.Ed.2d 341 (1980). The Statement of Policy is appended hereto as Appendix L; the portion which pertains to the type of communications here at issue is at pages 184a-187a.

dated August 5, 1977, the administrative law judge rejected Rochester's arguments and allowed only $598,876 for communication expenses, relying solely upon the commission's Statement of Policy as a basis for the portion disallowed. (Appendix I, p. 109a.)

In its brief on exceptions to the commission Rochester again argued that disallowance of its actual test period communication expenses was without record evidentiary support and was contrary to its right of free speech. On November 1, 1977 the commission issued its Opinion and Order Determining Revenue Requirement wherein it rejected Rochester's arguments, denied that the First Amendment right of free speech was implicated, and, relying solely upon its own Statement of Policy, disallowed $460,881 (or approximately 60 percent) of Rochester's communication expenses, asserting that Rochester had failed to meet its burden of proof to overcome the Statement of Policy. (Appendix H, pp. 61a.-63a.)

By application for rehearing dated November 30, 1977 Rochester sought rehearing on the disallowance of its communication expenses, again arguing that it was contrary to its right of free speech, was without evidentiary support and in violation of the Fourteenth Amendment. By its January 20, 1978 Order Granting in Part and Denying in Part Petition for Rehearing, the commission rejected Rochester's arguments, relying primarily upon its Statement of Policy but alluding to the testimony of the staff witness and that of the two intervenor witnesses for additional support. (Appendix G, pp. 35a.-37a.)

Rochester commenced judicial review of the commission's determination in New York Supreme Court, Albany County, pursuant to Article 78 of the New York Civil Practice Law and Rules, on May 19, 1978. In its petition Rochester asserted that the commission's disallowance of 60 percent of its communication expenses was contrary to its right of free speech and without evidentiary support. By Order entered June 1, 1978 the matter was transferred to the Appellate Division of the New York Supreme Court, Third Department. (Appendix F.)

In its briefs to the Appellate Division Rochester argued that the disallowance of its communication expenses in setting rates constituted a limitation upon its right of free speech and that the commission had failed to apply the standards required to sustain such a limitation. Rochester also argued that the commission's determination had no evidentiary support in the record. On November 9, 1978 the Appellate Division issued its opinion and order wherein it sustained the commission's determination. The Appellate Division, while expressing a lack of conviction that the right of free speech was applicable to Rochester and describing Rochester's informational communications as "propaganda," held that there was no direct limitation on free speech because Rochester could communicate freely by diverting revenues, provided in rates to cover the cost of shareholder capital, to pay for additional communication. The court also held that there was no indirect limitation because utility ratepayers are "not concerned with such niceties as the image of a utility" and are not required to pay for all advertising. The Appellate Division concluded that the commission's determination constituted "no infringement upon the freedom of speech" of Rochester. (Appendix E, p. 25a.) Thus the court did not address the commission's failure to apply the standards for testing an infringement under the First Amendment. On the question of evidentiary support for the commission's determination, the Appellate Division held that it was "not lacking for a reasonable basis," but, in so doing, the court relied upon the undisclosed, non-record evidence claimed by commission to underlie its Statement of Policy. (Appendix E, p. 27a.)

Following resolution of a separate issue which the Appellate Division had remitted to the commission (Appendix E, p. 29a, and Appendices B-D), Rochester appealed the issue of the disallowance of its communication expenses to the New York Court of Appeals. In its briefs to that court Rochester argued again that the disallowance of its communication expenses in setting rates is a limitation of free speech, and that the standards required by the First Amendment for determining whether or not a limitation is permissible were not applied by

the commission. Rochester also argued that there is no probative evidence in the record to support the commission's determination; and Rochester asserted that it is a denial of due process of law for a regulatory agency to make a determination in a rate proceeding without evidentiary support in the record of that proceeding or to sustain that determination on the basis of claimed but undisclosed evidence in the record of some other proceeding. On October 14, 1980 the Court of Appeals issued its judgment, affirming the order of the Appellate Division. In its brief memorandum decision the court below held that the commission's action "imposed no restraint, direct or indirect," upon Rochester's communications, and asserted that the Constitution imposes no duty upon government to ensure a person the resources with which to exercise constitutional rights. Finding no restraint, the court below did not address the standards by which such a restraint must be tested. (Appendix A, pp. 1a-2a.) On the question of evidentiary support, the court below held merely that "[i]t cannot be said that this ruling is . . . unsupported by substantial evidence," but gave no indication as to where or what such evidentiary support is. (Appendix A, p. 2a.)

THE FEDERAL QUESTIONS PRESENTED ARE SUBSTANTIAL

This appeal invokes critical constitutional provisions: the right of free speech guaranteed by the First Amendment and the right to due process of law guaranteed by the Fourteenth Amendment. Both of these rights have been seriously violated below. If the decision of the New York Court of Appeals stands, neither free speech nor due process will offer protection to the thousands of regulated public utilities in New York State and elsewhere.

In a proceeding for setting its rates, the commission disallowed 60 percent of Rochester's actual, historic level of communication expenses. In so doing, the commission has denied that the right of free speech is involved and has denied the need

for record evidence to support its disallowance; and the courts below have sustained the commission on both issues.

Rochester contends that to affirmatively deny the means essential to exercise the right of free speech necessarily limits the right itself and invokes the standards of the First Amendment. Rochester also contends that due process requires that the rate determinations of the governmental agencies charged with regulating public utilities must have a basis in record evidence. These two issues are crucial for the regulated public utilities in this nation.

The judicially sanctioned discretion allowed the regulatory agency is awesome. The regulatory agency has been conferred with "vast power." *Consolidated Edison Co. of New York, Inc. v. Public Service Comm'n*, 47 N.Y.2d, 94, 102, *rev'd on other grounds*, ____U.S.____, 65 L.Ed.2d 319 (1980). Great deference is given to the judgment of the regulatory body. *Ohio Bell Telephone Co. v. Public Utilities Comm'n*, 301 U.S. 292, 304 (1937). And, as stated in *New York State Council of Retail Merchants, Inc. v. Public Service Comm'n*, 45 N.Y.2d 661, 672, (1978):

> It is only when it can be shown that the exercise of judgment was without *any* rational basis or without *any* reasonable support in the record that the determination of the commission may be set aside . . . (Emphasis added.)

Faced with this overwhelming deference to the judgment of the governmental agency which regulates it, it is vital to the very existence of the public utility that judicial deference does not become judicial abdication. If the fundamental protection of constitutional rights does not apply then the public utility is at the mercy of administrative whim.

One fundamental right which is called into question by the decisions below, is that of due process. Heretofore the public utility has assumed that the requirements of due process impose upon regulatory bodies the obligation to base rate determinations on substantial evidence in the record. At least to that

degree public utilities have thought themselves to be protected from unfettered regulatory discretion. For, just as the power to tax is the power to destroy, the power to set public utility rates is the power to destroy the public utility. Yet, in the proceeding from which this appeal is taken there is *no* probative evidence in the record to support the commission's disallowance of Rochester's communication expenses. If the decision below stands then due process either is inapplicable to the regulated public utility or no longer requires that regulatory agency rate determinations have any basis in record evidence. In either case the public utility is indeed subject to the whim of the members of the regulatory agency.

The other, and even more fundamental right which is called into question by the decisions below is that of free speech. Given the pervasiveness of the regulation to which it is subject, few persons are more in need of the protection of the First Amendment than the public utility. As this Court has noted, regarding the free flow of information,

> ... if it is indispensible to the proper allocation of resources in a free enterprise system, it is also indispensible to the formation of intelligent opinions as to how that system ought to be regulated or altered.

Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council, Inc., 425 U.S. 748, 765 (1976).

This appeal involves neither "promotional" nor "political" communications. As noted by the Appellate Division in its opinion (Appendix E, p. 24 a), the total, test year communication expenditure of $780,000 was spent as follows: 33 percent for promoting conservation (*i.e.*, promoting reduced usage of Rochester's services); 14 percent for promoting safety (*i.e.*, avoidance of injury to customers through Rochester's facilities and safe use of its services); 11 percent for promoting service information (*i.e.*, information on how to obtain and maintain, and how to properly use, service); 1 percent for promoting educational/technical information (*i.e.*, technical appliance and installation data for dealers, repairmen, and do-it-yourselfers); 9

percent for promoting community activities (*i.e.*, civic and charitable activities and fund drives, and area economic development); 8 percent for communicating about energy costs (*i.e.*, the fact of, and reasons for, the rising cost of energy, including that supplied by Rochester); and 23 percent for communicating company information (*i.e.*, information about Rochester — its activities, plans, and problems). (*cf.* Appendix N-4, pp. 217a-226a.) Thus the communication with which the proceeding is concerned is all informational and "non-commercial." *Central Hudson Gas & Electric Corp. v. Public Service Comm'n*, ____U.S.____, 65 L.Ed.2d 341, 348 n. 5, 361 n. 4 (1980).

These are vital areas for communication between the public utility and its customers.

The benefit of these communications to both the utility *and* its customer would seem self-evident. Many of the enumerated areas of communication provide direct benefits to the customer, through a reduction in his own utility bill or the avoidance of a tragic accident. All of the areas of communication provide indirect benefits to the customer through a lower cost of service for the utility (and, hence, lower rates), fewer appliance service problems, and an improved community.

From the public utility perspective, the ability to communicate with its customers is critical. Given the pervasiveness of regulation and the wide latitude which the regulator possesses, the attitude of the customer is the true court of last resort for the utility. Without the meaningful ability to truthfully communicate with those customers, to explain its concerns and activities to them, the public utility may be condemned to extinction by default.

The court below has sanctioned the economic muzzling of the public utility, holding that to affirmatively deny it the means with which to exercise its right of free speech is "no restraint" upon its right. Thus the questions of whether such a restraint is or is not permissible under the standards of the First Amendment is not dealt with below. If the decision of the court below is

permitted to stand, the protection of the First Amendment for public utilities, so recently confirmed by this Court, will have been rendered largely meaningless.

POINT I

The Right of Free Speech Is Both Involved and Violated in the Proceedings Below.

The essence of the error below has been to treat an issue invoking the right of free speech as if it is no different from, and is subject to the same standards applicable to, the routine process of regulatory ratemaking, i.e., property rights due process. Thus the burden of proof has been imposed on Rochester, and it is presumed that the commission's determination is correct, regardless of what support in the record, if any, that determination may have.

This Court has recently confirmed that a regulated public utility and its communications are entitled to the full protection of the right of free speech. *Consolidated Edison Co. of New York, Inc. v. Public Service Comm'n,* ____U.S.____, 65 L.Ed.2d 319 (1980); *Central Hudson Gas & Electric Corp. v. Public Service Comm'n, supra.* The question which this case presents, however, is whether those cases are illusory in their confirmation of that right. The courts below, while purporting to acknowledge Rochester's First Amendment right, simply render that right meaningless by asserting the power of the commission to deny Rochester the means with which to exercise it. What the Supreme Court has clarified, the commission and the courts of New York destroy.

Rochester has not suggested that it is entitled to have provision made in its rates for whatever amount it wishes to expend upon communicating with its customers. On the contrary, Rochester believes that the commission may limit its rate allowance for communication expenditures. However, Rochester does assert (a) that such a limitation *is* a limitation upon Rochester's right of free speech and, as such, (b) that to sustain

such a limitation the standards dictated by the First Amendment must be followed. The errors below consist of asserting that *no* limitation of Rochester's right of free speech exists and, hence, of failing to apply the standards by which the permissibility of that limitation is to be judged.

A. *Denying the Regulated Public Utility the Revenues With Which to Pay the Cost of Communicating With Its Customers May or May Not Be Permissible — But It* Is *a Limitation Upon the Utility's Exercise of Free Speech.*

Neither the commission nor the courts below have reached the issue of the proper standards by which a limitation upon free speech is to be judged in the regulatory, ratemaking context. They have avoided that task by asserting that the denial of the revenues with which to pay for the exercise of the right of free speech, in setting Rochester's rates, is not a limitation upon that right. That assertion is contrary to the decisions of this Court and to reason.

This Court has recognized that "virtually every means of communicating ideas in today's mass society requires the expenditure of money." *Buckley v. Valeo*, 424 U.S. 1, 19 (1976). If one is denied the funds with which to pay the cost of communicating, then clearly one is denied the means of exercising the right to communicate.

The strictures of the First Amendment apply not only to direct bans on speech, but equally to actions which indirectly produce the same effect. In *NAACP v. Button*, 371 U.S. 415, 439 (1963), this Court stated that "regulatory measures . . . no matter how sophisticated, cannot be employed in purpose *or in effect* to stifle, penalize, *or curb* the exercise of First Amendment rights." (Emphasis added.) And in *United Mine Workers of America v. Illinois State Bar Ass'n*, 389 U.S. 217, 222 (1967), this Court noted:

> The First Amendment would, however, be a hollow promise if it left government free to destroy or erode its

> guarantees by indirect restraints so long as no law is passed that prohibits free speech . . . as such. We have therefore repeatedly held that laws which actually affect the exercise of these vital rights cannot be sustained merely because they were enacted for the purpose of dealing with some evil within the State's legislative competence, or even because the laws do in fact provide a helpful means of dealing with such an evil.

Perhaps more precisely, this Court has held that denial of the means with which to exercise a right is the same as a denial of the right itself. *Boddie v. Connecticut*, 401 U.S. 371 (1971).

Both reason and the decisions of this Court make it clear that to deny Rochester the means with which to exercise its right of speech is to deny Rochester the right itself. But the courts below and the commission have responded on two bases that such is not the case, and that no limitation has been imposed upon Rochester's exercise of its right of free speech. First the court below asserts that,

> . . . although the Constitution may provide a citizen the right to engage in a certain activity free of governmental restrictions, it places no general corresponding duty upon government to ensure the availability of all resources necessary to realize that freedom . . . .

and cites opinions of this Court to support that assertion. (Appendix A, p. 2a.) True enough, the cited cases appear to hold that government does not infringe upon a constitutionally protected right merely by failing to give over to a person the financial means to exercise that right. But that is not this case. The court below has failed to appreciate the nature of regulation and its impact upon the issue at hand. The court below has failed to distinguish between affirmatively providing the resources, on the one hand, and denying the opportunity to earn the resources, on the other hand. The latter is the situation in this case.

Rochester is not complaining that the commission failed to give it the funds with which to pay the expense of exercising its right of free speech; no governmental subsidy is sought. Rather, the issue here is the commission's refusal to permit Rochester to

charge rates sufficient to pay the cost of communicating with its customers. The regulated utility has no magic source of funds. It obtains the revenues needed to pay expenses only from the rates charged to customers. If the rates set by the regulatory body fail to provide for an expense, the utility is denied the means of paying that expense.[2] Here the regulatory body so set Rochester's rates as to deny it the sole means of earning the revenues needed to bear the expense of most of its communications. Rather than fail to *provide* the means, the commission has *denied* Rochester the means to exercise its right of free speech.

Can it be doubted that, if the New York Legislature passed a statute which levied a tax on corporations, equal to the expenditures of a corporation for communications in excess of 0.1% of its gross revenues, such a statute would be unconstitutional? *Murdock v. Pennsylvania*, 319 U.S. 105, 112-15 (1943); *Grosjean v. American Press Co.*, 297 U.S. 233 (1936). Yet this is, in effect, what the commission has been permitted to do in the rate-setting process. The only difference is that the commission, as the regulatory body in control of the "purse strings," has "levied" a "front-end tax" by denying the revenues in the first instance, in lieu of subsequently taxing them away.

The other basis on which both the courts below and the commission deny the fact of limitation upon Rochester's right of free speech is with the claim that the cost of communication, beyond that provided for in rates, can be borne out of the return on investment provided for shareholders. (Appendix A, p. 1a; Appendix E, p. 25a; Appendix G, p. 37a.) There are at least three reasons why this response is invalid.

First, in setting rates for a utility the commission is required to provide for a fair and reasonable return on invested capital —

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[2]But for regulation, the privately-owned public utility would be able to routinely recover such communication expenses in its charges to customers, just like other private businesses. *See, e.g., Central Hudson, supra*, ____ U.S. ____, 65 L.Ed.2d 352 n.11; *cf. also, First National Bank of Boston v. Bellotti*, 435 U.S. 765 (1978), and *Eastern Railroad Presidents Conference v. Noerr Motor Freight*, 365 U.S. 127 (1961).

i.e., for the *expense* of invested capital. As Justices Brandeis and Holmes stated in their dissenting opinion in *Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Comm'n*, 262 U.S. 276, 306 (1923):

> In essence there is no difference between the capital charge and operating expenses, depreciation and taxes. Each is a part of the current cost of supplying the service, and each should be met from current income.

The return provided for shareholders is an expense which stands on its own. It does not represent a fund out of which other expenses of the utility are to be met. *Cf. Board of Public Utility Comm'rs. v. New York Telephone Co.*, 271 U.S. 23, 30-32 (1926). It is clearly unlawful for Rochester's rates to be deliberately set in a manner which requires it to meet a portion of its expenses out of revenues provided for an entirely different expense.

Second, in setting rates the commission deliberately provides for only "the *minimum* cost of capital." *Long Island Lighting Company*, 16 NY PSC 497, 506 (1976) (emphasis added). In this proceeding the commission acknowledged: "The return on equity we allowed RG&E in this proceeding is minimal . . ." (Appendix G, p. 39a.) If the cost of communicating with customers must be deducted from an already minimum allowance to shareholders, then necessarily shareholders must receive less than a minimum fair return. Such a designed result is patently unconstitutional. *Board of Public Utility Comm'rs. v. New York Telephone Co., supra*, 271 U.S. 31. As phrased by another court, in *Mississippi River Fuel Corp. v. Federal Power Comm'n*, 163 F.2d 433, 437 (D.C.Cir. 1947):

> Expenses . . . are facts . . . . If properly incurred, they must be allowed as part of the composition of the rates. Otherwise, the so-called allowance of a return upon the investment, being an amount over and above expenses, would be a farce.

The commission and courts below would defend one constitutional violation (limiting Rochester's right of free speech) by resort to another constitutional violation (an unfair and inadequate return on investment).

Third, there can be no rational doubt that forcing a utility to deduct the cost of communicating with its customers from an already minimal shareholder return will, at the very least, cause the utility to communicate less than it otherwise would. This Court has made it clear that governmental action which will produce self-imposed limitations upon the exercise of the right of free speech is as offensive to the First Amendment as a direct restraint.[3] *New York Times Co. v. Sullivan*, 376 U.S. 254, 278-79 (1964).

It is clear that the *fact* of limitation present here may not lawfully be avoided by resort to the suggestion that communication can continue unrestrained merely by diversion of funds provided for the cost of shareholder capital. The commission has imposed a ceiling upon the revenues which Rochester may obtain for the purpose of communicating with its customers. Clearly this is a limitation upon Rochester's exercise of its right of free speech.[4] *The only issue which properly might have been in dispute in this proceeding is whether or not the commission's limitation is permissible under the standards laid down by this Court.* But, erroneously finding no limitation, the courts below failed to address or apply those standards.

Thus it is left to this Court to confirm that in *Consolidated Edison* and *Central Hudson* it was making more than the empty gesture imputed by the court below.

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[3]Indeed, at an earlier date the commission itself seemed to recognize this point:

> If we were to preclude recovery of such expenditures in rates we would, in effect, be telling the companies that if they do any such advertising it will come out of their return, which we try in any event to set at the minimum cost of capital. We are unwilling in that indirect way even to appear to stifle the wide public discussion of these issues that we think desireable.

Long Island Lighting Co., 16 NY PSC 497, 506 (1976).

[4]As this Court has phrased the point in *Buckley v. Valeo*, *supra*, 424 U.S. 19 n. 18:

> Being free to engage in unlimited . . . expression subject to a ceiling on expenditures is like being free to drive an automobile as far and as often as one desires on a single tank of gasoline.

B. *The Standards Imposed by the First Amendment, Requiring That the Governmental Body Which Seeks to Impose a Limitation Upon the Exercise of Free Speech Bear the Burden of Proof With a Clear and Compelling Showing That Such Limitation Is Necessary and No More Than Necessary, Are Applicable in the Regulation of the Public Utility.*

Rochester does not claim that the First Amendment bestows upon it the right to spend, and recover from its ratepayers, unlimited amounts for communicating with those ratepayers. Such a result would render largely meaningless the whole concept of regulated public utility rates.

This case presents to this Court an issue not heretofore determined insofar as we are aware: how are the constitutional standards required by the First Amendment to be accommodated within the structure of public utility rate regulation? The courts below have not reached this issue simply by denying that the First Amendment is involved.

The commission and the courts below have purported to judge the disallowance of Rochester's communication expenses solely in the context of property rights due process. They have purported to apply the same standards to the allowability of communication expenses as would be applicable to any other issue in a ratemaking proceeding. However, this Court has repeatedly held that very different standards are applicable when the First Amendment is properly invoked. This Court has made clear beyond dispute that the First Amendment has a priority and sanctity which places it above other rights. *Thomas v. Collins*, 323 U.S. 516, 529-30 (1945). And this Court has made it equally clear that the higher sanctity of the right of free speech requires much higher standards of due process. In a very relevant passage in *West Virginia State Board of Education v. Barnette*, 319 U.S. 624, 639 (1943), this Court stated:

> Much of the vagueness of the due process clause disappears when the specific prohibitions of the First become its standard. *The right of a State to regulate, for example, a public utility may well include, so far as the due process*

> *test is concerned,* power to impose all of the restrictions which a legislature may have a "rational basis" for adopting. *But freedoms of speech* and of press . . . *may not be infringed on such slender grounds.* (Emphasis added.)

Yet, unless this Court reverses the judgment of the court below, for the public utility there will be no difference in the standards by which its property rights and its right of free speech are to be regulated. Free speech will be just another right, rather than a right of the highest sanctity.

Although steadfastly ignored by the commission and the courts below, the applicable standards by which the commission's limitation upon Rochester's right of free speech is to be judged have been set forth previously by this Court.

1. *Burden of Proof*

In general, New York law places the burden of proof upon the regulated utility to show that its proposed rates are just and reasonable. N.Y. Public Service Law §66(12). While, unlike the *Consolidated Edison* and *Central Hudson* cases, the court below has given us a very small "target" by writing only a brief memorandum opinion, the record makes it indisputable that the commission and the courts below imposed the burden of proof on Rochester on this issue throughout the proceeding. (Appendix E, p. 28a; Appendix G, p. 37a; Appendix H, p. 62a.)

However, where the First Amendment is involved this Court has repeatedly held that the burden of proof is upon the governmental body which seeks to impose the limitation, not upon the person whose right of speech is being limited. *First National Bank of Boston v. Bellotti, supra,* 435 U.S. 786; *Southeastern Promotions, Ltd. v. Conrad,* 420 U.S. 546, 560 (1975); *Freedman v. Maryland,* 380 U.S. 51, 58 (1965); *Speiser v. Randall,* 357 U.S. 513, 528 (1958).

There is no reason why this standard imposed by the First Amendment should be inapplicable to the regulatory ratemaking process. If the public utility can cope with the burden on virtually all of the other issues, there is no reason that

the regulatory agency should be deemed unable to cope with bearing the burden of proof on the single issue of speech limitations. While property rights due process may permit imposition of the burden of proof upon the public utility on other issues, to do so as to communication expenses is to write second-class status for public utilities into the First Amendment.

2. *Quality of Showing*

The normal standard of judicial review of a commission determination is whether or not that determination has a rational basis and is supported by substantial evidence. *Cf. New York State Council of Retail Merchants, Inc. v. Public Service Comm'n, supra;* N.Y. Civil Practice Law and Rules §7803. The opinions below leave no question but that this was the standard by which the commission's determination here at issue was judged. (Appendix A, p. 2a; Appendix E, pp. 25a, 27a.)

Where the First Amendment is involved this Court has held that a rational basis or mere substantial evidence will not suffice. The First Amendment requires that the showing required of the governmental body, to sustain its limitation of free speech, must be "clear" and "compelling." *First National Bank of Boston v. Bellotti, supra,* 435 U.S. 786; *Thomas v. Collins, supra,* 323 U.S. 530; *West Virginia State Board of Education v. Barnette, supra,* 319 U.S. 639. As noted in the concurring opinion in *McKinney v. Alabama,* 424 U.S. 669, 683-85 (1976), this is the equivalent of requiring, in a civil case, proof "beyond a reasonable doubt."

There is no reason why this standard imposed by the First Amendment should be inapplicable to the regulatory ratemaking process. On virtually every other issue which a public utility may wish to challenge it must meet a burden of showing that there is, in the record, *no* proof of such quality and quantity as could persuade a detached fact-finder to reach the same conclusion as did the regulatory agency. *Cf. 300 Gramatan Avenue Assocs. v. State Division of Human Rights,* 45 N.Y.2d 176, 181 (1978). If the public utility is expected to meet such a

burden on virtually any other issue there is no reason why the regulatory agency should not be held to a similarly stringent standard to sustain its limitation upon the utility's exercise of free speech. To single out the public utility for limitations upon its right of free speech on the basis of merely substantial evidence or a "rational basis" is to impute an exception to the First Amendment where none is written.

3. *Expenditure Level*

While it is clear that, to sustain a limitation upon the right of free speech, the governmental agency which seeks to impose the limitation bears the burden of proof and must make a showing which is clear and compelling — beyond a reasonable doubt, we have found no cases dealing with the First Amendment wherein this Court has indicated just what, in the present circumstances, the regulatory agency must clearly and compellingly show. We believe, however, that a prior decision of this Court, not involving the First Amendment, provides an answer on the latter point.

In most situations it would be unnecessary to seek any further standard. This Court has held that "[t]he First Amendment denies government the power to determine that spending to promote one's . . . views is wasteful, excessive, or unwise." *Buckley v. Valeo, supra,* 424 U.S. 57. However, the very nature of rate regulation with which regulatory bodies are charged precludes an open-ended, infinite allowance for public utility communication expenses. If the standards required by the First Amendment are to be applied in a manner consistent with public utility rate regulation, a further standard, unique to the regulatory forum, is required. But, to be consistent with the First Amendment, the accommodation must be the narrowest possible (*Thomas v. Collins, supra,* 323 U.S. 530) and no greater than necessary (*First National Bank of Boston v. Bellotti, supra,* 435 U.S. 786). Such a standard already exists.

In *West Ohio Gas Co. v. Public Utilities Comm'n (No. 1),* 294 U.S. 63, 72 (1935), this Court held that "[w]ithin the limits of

reason" a public utility must be allowed its promotional advertising expenses in the setting of its rates. Although in *Central Hudson* this Court noted this point with apparent approval (____U.S.____, 65 L.Ed.2d 352 n. 11), *West Ohio* was decided in the context of property rights due process, not in the context of the First Amendment. Given the far greater sanctity of the First Amendment, can a lesser standard be applicable to free speech than that applicable to property rights?

While "the limits of reason" is not a wholly objective standard, it is one with which both courts and administrative bodies are familiar. Being a frequent standard in other areas of rate regulation, it must necessarily satisfy the regulatory mandate. And, when coupled with placement of the burden of proof upon the regulatory agency, to make a clear and compelling showing, such a standard appears to meet the minimum requirements of the First Amendment.

Accordingly, it has been Rochester's position throughout this litigation that: A regulatory agency *may* limit the amount allowed a public utility in rates for the expense of communicating with its customers. But, to do so, the regulatory agency has the burden of showing, clearly and compellingly — beyond a reasonable doubt, that the expenditure level sought by the public utility exceeds the limits of reason and that the level to which the agency has reduced the expense allowance is no lower than is necessary to bring it within the limits of reason.

With the extreme deference given to the determinations of regulatory agencies by the courts, any lesser requirement will render the guarantee of the First Amendment meaningless for public utilities, as this case so vividly demonstrates.

C. *The Showing Required of a Regulatory Agency, In Limiting the Right of Free Speech of a Public Utility, Is Wholly Absent in This Record.*

The potential for First Amendment mischief in the rate-regulation process is fully realized in this case. For, as we discuss in Point II, *infra*, the record in this proceeding shows that there

is *no* probative evidence — much less substantial, and even less clear and compelling, evidence — to support the commission's disallowance of the major portion of Rochester's communication expenses. What the commission has done is to set in advance an arbitrary percentage level, and to then disallow all expenditures above that level.

The court below, in citing *New York State Council of Retail Merchants, Inc. v. Public Service Comm'n, supra,* 45 N.Y.2d 671-72, has made clear its reliance upon a presumption of commission judgment and expertise. (Appendix A, p. 2a.) However, as this Court noted long ago, "[t]he power to create presumptions is not a means of escape from constitutional restrictions." *Bailey v. Alabama,* 219 U.S. 219, 239 (1911).

Thus, while this Court has so recently confirmed the applicability of the right of free speech to the regulated public utility, the commission, with the blessing of the courts below, would make an empty promise of that right. For the courts below would permit the regulatory agency to deny the public utility the essential means with which to exercise its right, and to do so without assuming any burden of proof and without any record basis.

What this Court confirms, the commission and the courts below circumvent. Absent reversal of the decision below the public utility has only that right of free speech that the regulatory agency chooses, in its sole discretion, to allow.

POINT II

Basic Due Process of Law Has Been Denied in the Proceedings Below.

Public utilities have long assumed that, although the regulatory bodies which determine their rates have broad powers, and although the informed judgment of such bodies is given great deference by the courts, the utility at least is protected by the requirements of due process. This case, if the judgment below is not reversed, destroys that assumption and

removes the protection of due process from the public utility in the State of New York.

By statute, the rate determinations of the commission must be supported by substantial evidence. Article 78 of the New York Civil Practice Law and Rules provides, as a basis for judicial review, the question of whether the "determination made as a result of a hearing held, and at which evidence was taken, pursuant to direction by law is, on the entire record, supported by substantial evidence." *Id.* at §7803(4). Public hearings were held in this case, at which evidence was taken. (*E.g.*, *see* Appendices N-1 - N-4.) Such hearings were "pursuant to direction by law." N.Y. Pub. Serv. Law §66(12).

However, regardless of New York law, the requirements of due process imposed upon the States by the Fourteenth Amendment require that the regulatory body setting the rates of a public utility base its determination upon evidence duly included in the record at a fair and open hearing. *Ohio Bell Telephone Co. v. Public Utilities Comm'n, supra,* 301 U.S. 300-05.

This requirement has been wholly ignored in this proceeding. There is *no* probative evidence in the record to support the commission's disallowance of Rochester's communication expenses. Surely we have not reached such a state of regulation that an agency determination can be based upon a claim of evidence which is offered for review neither to the regulated utility nor to the courts.

We do not know to what "evidence" the court below had reference when it asserted that "[i]t cannot be said that . . . [the commission's determination] is . . . unsupported by substantial evidence" (Appendix A, p. 2a), since its memorandum decision denies us that information. But we *do* know that, with all due respect to the court below, it can indeed be said that the commission determination is unsupported by substantial evidence. For we do know what "evidence" was claimed by the commission to underlie its determination as well as what "evidence" was relied upon by the Appellate Division in sustaining that determination, and we know of no other "evidence" which does,

or is claimed to, support the commission's determination on this issue.

In its original decision the commission based its determination *solely* on its *Statement of Policy on Advertising and Promotional Practices of Public Utilities* (Appendix L), which had been issued after Rochester had filed its direct evidence in the proceeding. (Appendix H, pp. 61a-63a). In its *Order Granting in Part and Denying in Part Petition for Rehearing* ("order on rehearing"), responding to Rochester's point that there was no evidence in the record to sustain its determination, the commission belatedly claimed to have relied also upon testimony of two intervenor witnesses and of one of its staff. (Appendix G, p. 36a.) However, in its briefs to the courts below, the commission did not argue record support, but instead pointed to the "thorough analysis" which, *it claimed*, underlay its Statement of Policy, as the evidentiary basis for its determination — a position which the Appellate Division adopted in sustaining the commission determination. (Appendix E, pp. 25a-27a.) None of the only three bases claimed to provide evidentiary support for the commission's determination constitute the probative, record evidence required by due process.

A. *A Utility's Expenses Are Presumed Reasonable and Proper Absent a Showing to the Contrary.*

A proceeding for setting the rates of a public utility necessarily involves the validity of literally hundreds — even thousands — of items of expense. While the utility normally bears the burden of proof on issues which arise during the course of the proceeding, the utility is not called upon to prove the reasonableness and propriety of each and every item of expense. A rate setting proceeding would become wholly unmanageable if the law were otherwise.

Instead, as a matter of due process, the expenditures of the utility are presumed to be reasonable and proper — and hence must be included in the setting of its rates — unless and until an evidentiary showing is made to the contrary. *West Ohio Gas Co. v. Public Utilities Comm'n (No. 1), supra*, 294 U.S. 72; *Missouri*

ex rel. Southwestern Bell Telephone Co. v. Public Service Comm'n, supra, 262 U.S. 289. This due process requirement recognizes both the fact that the regulated public utility remains private property and the constitutional right of the owners of property to protect that property.

Thus, absent an evidentiary showing to the contrary, the presumption that a utility's expenditures are reasonable and proper is sufficient and requires that such expenditures be included in the computation of its rates. No contrary showing exists in this proceeding regarding Rochester's communication expenditures.

B. *A Statement of Policy Is Neither Evidence Nor a Substitute for Evidence.*

Originally the commission, in disallowing most of Rochester's communication expenses, relied solely upon its own Statement of Policy. (Appendix H, pp. 61a-63a.) Thus, by fiat, expressed in a statement of policy, the commission has set an arbitrary level of from .0004 to .001 of gross revenues above which it will not allow communication expenses in setting rates. (Appendix H, p. 62a and Appendix G, p. 37a.) Such arbitrary percentage regulation has long-since been held unlawful. *West Ohio Gas Co. v. Public Utilities Comm'n (No. 1), supra,* 294 U.S. 68. As was noted in *Mississippi River Fuel Corp. v. Federal Power Comm'n, supra,* 163 F.2d 437: "Expenses . . . are facts. They are to be ascertained, not created, by the regulatory authorities."

Most directly on point, in *Pacific Gas & Electric Co. v. Federal Power Comm'n,* 506 F.2d 33, 38-39 (D.C.Cir. 1974), the court held:

> The agency cannot apply or rely upon a general statement of policy as law because a general statement of policy only announces what the agency seeks to establish as policy .... When the agency applies the policy in a particular situation, it must be prepared to support the policy just as if the policy statement had never been issued. An agency cannot escape its responsibility to present evidence and reasoning supporting its sub-

stantive rules by announcing binding precedent in the form of a general statement of policy.

Not only is the Statement of Policy not evidence or a substitute therefor, but the Statement of Policy itself specifically stated that its guideline range of .0004 to .001 was only a "probability," and that the amount to be allowed for each utility "... will be determined individually for each company, in its next or pending rate case, on the basis of various other factors ...." (Appendix L, p. 186a; footnote omitted.)

It is clear that, as a matter of law, the commission's Statement of Policy is neither probative evidence nor a substitute for such evidence.

C. *The Record in This Proceeding Contains No Probative Evidence Showing That Rochester's Communication Expenses Were Unreasonable or Improper.*

In its order on rehearing the commission pointed to the testimony of two intervenor witnesses and that of a commission staff witness as providing evidentiary support for its disallowance of Rochester's communication expenses. (Appendix G, p. 36a.) We have included all of that testimony in the appendix to this jurisdictional statement (Appendices N-1 - N-3) because it is relatively short and because it shows on its face that such testimony provides no probative evidence on the issue.

The staff witness acknowledged that his recommendation to disallow a portion of Rochester's communication expenses was *not* based upon an analysis of the "specific characteristics and circumstances" of Rochester (Appendix N-1, p. 205a), but, rather, was based solely on an arbitrary application of the commission's Statement of Policy guideline (Appendix N-1, p. 208a). Being based solely on the Statement of Policy, the testimony of the staff witness is no more probative evidence than is the Statement of Policy itself.

The testimony of the two intervenor witnesses cited by the commission in its order on rehearing did no more than protest Rochester's communication expenditures; neither offered any

analysis of why Rochester's expenditure level should be adjudged unreasonable or improper. (Appendices N-2 and N-3.) The commission itself, in its order on rehearing, noted that the testimony of these two witnesses merely "questions" Rochester's expenditure level. (Appendix G, p. 36a.) As a matter of law, such testimony is insufficient. "A case of this sort does not call for minute paring of items protested but not attacked by proofs." *New York & Richmond Gas Co. v. Prendergast*, 10 F.2d 167, 181 (E.D.N.Y. 1925). A suggestion of what ought to be is not a substitute for an evidentiary showing. *Cf. Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc.*, 435 U.S. 519, 553-54 (1978). Further, the commission candidly acknowledged that the matters raised by these two witnesses "were not evaluated." (Appendix G, p. 36a). Surely unevaluated testimony cannot be the basis for a determination.

None of the record testimony provides probative evidence in support of the commission's determination. That may explain why, in its briefs to both of the courts below, the commission did not argue that the evidence in *this* proceeding provides support for its determination, and why the Appellate Division based its finding of evidentiary support upon the evidence *claimed* to underlie the commission's Statement of Policy (Appendix E, p. 27a) rather than anything in the record in *this* proceeding.

D. *It Is a Denial of Due Process to Base a Determination in This Proceeding Upon Alleged Evidence Which Is Not Included in the Record.*

While the brief opinion of the court below does not disclose the substantial evidence which it apparently found to underlie the commission's determination, as we have noted, in both courts below the commission argued only that evidence *alleged* to underlie its Statement of Policy provides evidentiary support for its determination, and the Appellate Division explicitly relied upon that claimed evidence. There is nothing else upon which the court below could have relied. Whatever "evidence" may be *claimed* to underlie the commission's .0004 to .001 "guideline" range of allowable communication expenses, as promulgated in

its Statement of Policy, such "evidence" is neither disclosed nor contained in the record of *this* proceeding.

It is a denial of due process for a regulatory agency to base its determination of a contested issue in a rate making proceeding upon "evidence" which is not introduced in evidence in the proceeding, or even disclosed. *Ohio Bell Telephone Co. v. Public Utilities Comm'n, supra,* 301 U.S. 300-03; *United States v. Abilene & Southern Ry.*, 265 U.S. 274, 288 (1924).

E. *The Record as a Whole Cannot Support the Commission's Determination.*

As summarized in the foregoing, the record contains *no* probative evidence — much less substantial evidence — to support the determination of the commission or the sustaining of that determination by the courts below. Yet it is the whole record on which a determination of the issue at hand is to be evaluated. Given the lack of showing to the contrary, the presumption that Rochester's expenditure level is reasonable and proper stands undiminished and sufficient to require the inclusion of the expenses at issue in rates. Further, the record also contains extensive evidence on behalf of Rochester showing the present and prospective reasonableness and propriety of those expenses. (Appendix N-4, pp. 217a-233a.)

If due process remains applicable to the public utility rate-setting process, and if due process continues to require that regulatory determinations be based upon substantial record evidence, then the determination below cannot stand. It is critical to all public utilities that this Court reaffirm the requirements and applicability of due process in regulatory agency activities.

CONCLUSION

This appeal raises fundamental constitutional issues which are of critical importance to every public utility. First, it raises the questions of whether the regulatory agency's affirmative denial to the regulated entity of the means with which to exercise the right of free speech is a limitation upon that right and, if so, of how the standards by which a speech limitation must be judged are to be integrated with the process of rate regulation. The resolution of these issues will determine whether the decisions of this Court in *Central Hudson* and *Consolidated Edison* were more than mere illusion.

Second, this appeal raises the questions of whether due process requires that a regulatory agency determination of a contested issue in a rate setting proceeding be supported by evidence in the record of that proceeding, or whether, instead, such determination can be based upon either a mere statement of policy issued by the regulatory agency or the undisclosed evidence claimed to underlie that policy statement.

Appellant respectfully submits that this appeal raises substantial federal constitutional questions and that probable jurisdiction should be noted.

Respectfully submitted,

RICHARD NEILL GEORGE
Nixon, Hargrave, Devans & Doyle
Lincoln First Tower
Rochester, New York 14603
Telephone: (716) 546-8000

Attorney for Appellant

Of Counsel:
ROBERT L. DAILEADER, JR.

January, 1981

CERTIFICATE OF SERVICE

I hereby certify that on the 9th day of January, 1981, three copies of the foregoing Jurisdictional Statement and of the separate Appendix thereto were served upon the Public Service Commission of the State of New York by mail by depositing the same in a United States post office, first class postage prepaid, addressed to Peter H. Schiff, Esq., General Counsel, Public Service Commission of the State of New York, Agency Building No. 3, The Governor Nelson A. Rockefeller Empire State Plaza, Albany, New York 12223. I further certify that all parties required to be served have been served.

Dated this 9th day of January, 1981, at Rochester, New York.

RICHARD NEILL GEORGE
Counsel for Appellant
Nixon, Hargrave, Devans & Doyle
Lincoln First Tower
Rochester, New York 14603
Telephone: (716) 546-8000

80-1152

No. _____

In The

Supreme Court of the United States

OCTOBER TERM, 1980

ROCHESTER GAS AND ELECTRIC CORPORATION,
Appellant,

v.

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
Appellee.

On Appeal From The Court Of Appeals Of The State Of New York

APPENDIX TO JURISDICTIONAL STATEMENT

RICHARD NEILL GEORGE
Nixon, Hargrave, Devans & Doyle
Lincoln First Tower
Rochester, New York 14603
Telephone: (716) 546-8000

Attorney for Appellant

Of Counsel:
ROBERT L. DAILEADER, JR.

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Appendix A
Opinion of the Court of Appeals of the State of New York, October 14, 1980

STATE OF NEW YORK
COURT OF APPEALS

3 No. 432
In the Matter of Rochester
Gas and Electric Corporation,

Appellant,

v.

Public Service Commission,

Respondent.

(432) Richard N. George & William S. Andrews, Rochester, for appellant.

Howard J. Read, Peter H. Schiff, & Sigrid J. Hammond, Albany, for respondent.

MEMORANDUM:

The determination appealed from and the order of the Appellate Division brought up for review should be affirmed, with costs.

On this appeal, petitioner-utility asserts that it has a first amendment right to have its ratepayers bear the expense of certain informational advertising which the Public Service Commission has found to be unnecessary to the furnishing of utility services. We disagree.

There is no doubt that petitioner's expressional activity is entitled to first amendment protection (see, e.g., *Central Hudson Gas & Electric* v *Public Service Commission*, 447 US ____, 100 S Ct ____). But the Public Service Commission in this case has imposed no restraint, direct or indirect, upon petitioner's advertising or communications. Instead, the Commission has merely refused to include a portion of petitioner's information advertising as an allowable expense, and determined that such costs should be paid by the utility share-holders. Thus, the PSC

has ruled that the ratepayers should bear part, but not all, of the informational advertising costs. Petitioner claims, in essence, that it has a constitutional right to have the ratepayers defer the entire cost.

It is an accepted principle that, although the Constitution may provide a citizen the right to engage in a certain activity free of governmental restrictions, it places no general corresponding duty upon government to ensure the availability of all resources necessary to realize that freedom (see, e.g., *Harris v McRae*, 448 US ____, 48 USLW 4941, 4946-4947; *Norwood v Harrison*, 413 US 455, 462). Thus, the Public Service Commission is not obliged to allow the utility to charge ratepayers for all communications which the utility may choose to make. On this view of the case, it is unnecessary to address the contention, made by the Commission, that inclusion of the entire cost of informational advertising as an allowable expense would violate the first amendment rights of ratepayers (cf *Abood v Detroit Board of Education*, 431 US 209).

In response to petitioner's remaining arguments, it is sufficient to note that a prime function of the Commission, as a regulatory body is to separate those costs which should be borne by ratepayers from those which are properly chargeable to shareholders. The Commission has exercised that function here, ruling that informational advertising which serves to enhance the utility's image and is not necessary to the rendition of utility services should not be included as an allowable expense. It cannot be said that this ruling is arbitrary, capricious or unsupported by substantial evidence (e.g., *Matter of New York State Council of Retail Merchants v Public Serv. Comm. of State of N.Y.*, 45 NY2d 661, 671-672).

* * * * * *

Determination appealed from and order of the Appellate Division brought up for review affirmed, with costs, in a memorandum. All concur. Gabrielli, J., taking no part.

Decided October 14, 1980

Appendix B
Order of the Public Service Commission of the State of New York Adopting Administrative Law Judge's Recommended Decision, July 5, 1979

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

At a session of the Public Service Commission held in the City of Albany on June 26, 1979

COMMISSIONERS PRESENT:

Charles A. Zielinski, Chairman
Edward P. Larkin
Harold A. Jerry, Jr.
Anne F. Mead

CASE 27108 – ROCHESTER GAS AND ELECTRIC CORPORATION – Electric Rates – Hearing on Remand

CASE 27109 – ROCHESTER GAS AND ELECTRIC CORPORATION – Gas Rates – Hearing on Remand

ORDER ADOPTING ADMINISTRATIVE LAW JUDGE'S RECOMMENDED DECISION

(Issued July 5, 1979)

BY THE COMMISSION:

Our initial determination of just and reasonable rates in this proceeding was made on November 1, 1977.[1] At that time, we directed Rochester Gas and Electric Corporation to cancel suspended tariffs that were designed to generate a $20 million increase in annual electric revenues and a $7 million increase in annual gas revenues. We authorized it to file substitute schedules designed to produce a $10 million annual electric

[1]Opinion No. 77-18.

increase and a $2.5 million gas increase. RG&E filed new rates in compliance with our order and brought an Article 78 proceeding to review various aspects of the decision that were unfavorable to the company.

The Appellate Division confirmed our determination in part but remanded for further proceedings "as to the appropriate allowance of a rate increase for the wage increase." In response to the remand, we instituted hearings and Administrative Law Judge Vincent P. Furlong has now presented to us for our consideration a recommended decision in which he concludes that RG&E should be permitted to recoup $655,193 in electric revenues, $24,299 in street lighting revenues and $290,232 in gas revenues for the period from February, 1978 through April, 1979. These amounts represent the difference between the 6% wage and salary increase allowance we approved and the actual 7.82% increase the company implemented in February of 1978. The Judge would terminate the recovery period as of April 30, 1979 because new rates resulting from RG&E's most recent rate proceeding (Cases 27370, 27371 and 27372) became effective early in May. He also concludes that these amounts should be recovered by means of a per unit surcharge over a twelve-month period.

On the basis of our examination of the record made in this proceeding, we conclude that the Administrative Law Judge's ultimate recommendations should be adopted as the decision of the Commission. We believe that the result he reached is reasonable; but, in light of the fact that the parties to this proceeding have chosen not to take exception to the Judge's findings, and because the only disputable issues that his discussion presents are minor in nature, we do not reach those

issues.[1] For this reason, our decision here should not be taken as determinative in any future proceeding of the respective merits of the potentially contestable issues raised in this case.

The Commission orders:

1. The Administrative Law Judge's decision, dated May 7, 1979, is adopted as the decision of the Commission in this proceeding.

2. Rochester Gas and Electric Corporation is authorized to file such amendments to its electric and gas tariff schedules that will produce additional revenues in an amount and manner consistent with our findings and conclusions in this decision. The company may recoup $655,193 in electric revenues, $24,299 in street lighting revenues and $290,232 in gas revenues by means of a per unit surcharge over a twelve-month period. The amendments shall not take effect until approved by the Commission.

3. This proceeding is continued.

By the Commission,

(SEAL) (SIGNED) SAMUEL R. MADISON
Secretary

---

[1]For example, Judge Furlong observes at mimeo 7 of his recommended decision (which is attached) that if we had granted RG&E's request for a hearing and subsequently approved its entire wage increase, the administrative process would have delayed implementation of the new rates and the overall recovery we approve here could have been less than the amount RG&E claims. Likewise, we do not address the merits of calculating a pro rata award for the one day in May, 1979 that tariffs resulting from this case were in effect. (See mimeo 6 of the recommended decision.)

Appendix C
Recommended Decision of the Administrative Law Judge of the Public Service Commission of the State of New York, May 9, 1979

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 27108 – ROCHESTER GAS AND ELECTRIC CORPORATION – Electric Rates. HEARING ON REMAND.

CASE 27109 – ROCHESTER GAS AND ELECTRIC CORPORATION – Gas Rates. HEARING ON REMAND.

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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 27108 – ROCHESTER GAS AND ELECTRIC CORPORATION – Electric Rates. HEARING ON REMAND.

CASE 27109 – ROCHESTER GAS AND ELECTRIC CORPORATION – Gas Rates. HEARING ON REMAND.

APPEARANCES:

Sigrid J. Hammond, Esq., Staff Counsel, The Governor Nelson A. Rockefeller Empire State Plaza, Agency Building No. 3, Albany, New York 12223, for the Staff of the Department of Public Service.

Nixon, Hargrave, Devons & Doyle, Esqs. (by Richard N. George, Esq. and Michael R. Lindburg, Esq.), Lincoln First Tower, Rochester, New York 14604, for Rochester Gas and Electric Corporation.

(Appearances in Original Proceedings
Listed in Appendix I)

VINCENT P. FURLONG, Administrative Law Judge:

I. *INTRODUCTION*

By Opinion and Order issued in these proceedings on November 1, 1977 (Cases 27108 and 27109, Opinion No. 77-18) the Commission authorized tariff filings by Rochester Gas and Electric Corporation (RG&E) designed to produce additional annual electric revenues (including street lighting revenues) of $10,186,000 and additional annual gas revenues of $2,536,000. The Commission also authorized RG&E to file tariff amendments effective in February, 1978 to reflect anticipated wage increases stating as follows:

> "We shall permit RG&E to file tariff revisions to be effective in February, 1978 to recover actual wage and

> salary expenses that will become effective at that time but, since the increase is not subject to collective bargaining, in no event will we allow an amount greater than the 6% increase estimated in this proceeding. We find this amount reasonable and the company can effectively preclude a higher increase from being paid." (Opinion No. 77-18, mimeo p. 14).

Tariff filings embodying the foregoing authorization were filed and became effective on February 2, 1978 (gas), February 18, 1978 (electric, exclusive of street lighting) and March 1, 1978 (street lighting). While the tariff filings reflected only the authorized (for ratemaking purposes) 6% wage and salary increases, the actual increases amounted to 7.82% on average.

RG&E sought court review of, among other matters, that portion of the Commission's determination which limited recognition of the wage increase to 6%. On November 9, 1978, the Appellate Division, Third Department, modified the Commission's determination to the extent of annulling the wage increase limitation and remitted the matter to the Commission "for further proceedings as to the appropriate allowance of a rate increase for the wage increase." (*Rochester Gas and Electric Corp.* v. *P.S.C.*, ____ A.D. 2d ____, Third Department, 1978).

By order issued January 17, 1979, in response to the Court's decision, the Commission directed RG&E (if the Company wished to pursue the matter) to present evidence in support of a further rate increase within 21 days of the issuance of the aforesaid order and to serve copies thereof on all parties to the original proceedings. The Commission also directed that further hearings be held and stated that, among the issues to be considered "are the extent to which the wage increase granted in February, 1978 reflected merit increases, the proper productivity offset to the actual increase granted, and the proper effective date of any new rates to be authorized."

Appendix C

The prefiled testimony of Mr. Robert C. Henderson, Assistant Controller, RG&E, was received on February 13, 1979 and a public hearing was thereafter held in Rochester, New York on March 27, 1979. The only participant, other than the Company, was the Department of Public Service Staff which confined its participation to a brief cross-examination of Mr. Henderson's presentation.

II. *THE COMPANY'S PRESENTATION*

A. *The Wage and Salary Increase*

Company witness Henderson testified as to the wage and salary increases effective February 1, 1978 for both hourly and salaried employees. The actual increase was 7.82% consisting of an average 7.4% increase to hourly employees (67.7% of the work force) and an 8.7% increase to salaried employees (32.3% of the work force). A comparison of RG&E's computations of annual revenue requirements (net of productivity gains) based on the 6% wage increase authorized by the Commission and the 7.82% increase actually implemented is contained in Appendix II. Appendix II also contains a summary of data pertaining to the February 1, 1978 wage increase and a computation of the Company's additional revenue requirement for the period February, 1978 through May, 1979. Based on actual figures for February, 1978 through March, 1979 and forecast data for April and May, 1979, the Company's calculations show a revenue deficiency for the 16 month period, as the result of the Commission's limitation, of $700,372 (electric department excluding street lighting), $26,059 (street lighting) and $306,041 (gas department).

B. *Merit Increases*

RG&E's hourly employees received wage increases of 7.5% which were made up of a 5.5% general increase and a merit

increase of up to 2% for employees whose performance was satisfactory. Since all hourly employees did not receive the full 2% merit increase, the average hourly employee wage increase was 7.4% rather than 7.5%. Salaried employees of RG&E do not receive general wage increases; however, based on their performance, salaried employees were authorized merit increases which average 8.7%[1]. Mr. Henderson was of the opinion that, while merit increases are given primarily in recognition of past performance efforts, it is reasonable to anticipate that recognition of past performance will tend to promote prospective performance improvements.

C. *Productivity*

Mr. Henderson stated that he believed that the computed additional revenue requirement has more than adequately provided for productivity. While the Company continues to maintain that the productivity formula adopted in these proceedings results in a duplication of productivity adjustments contained in RG&E's original filing, it nevertheless applied that formula to determine the offset for both the 6% and 7.82% wage increases. Mr. Henderson pointed out that the Company's actual experienced 1978 operating expense wages exceeded the levels originally requested by the Company prior to adjusting for productivity. He also noted that, measured by the Consumer Price Index, the rate of inflation for the twelve months preceding RG&E's Board of Directors' approval of the wage increase was 6.7% and for the twelve months ended November, 1978, was 9.0%. Mr. Henderson claimed that, because of graduated per-

[1]Salaried employees received only one increase during the year. Mr. Henderson testified that hourly employees are entitled to periodic merit increases during the year but, because of difficulties in computation, the Company was claiming reimbursement only for the initial merit increase which became effective in February, 1978.

sonal income tax rates and increased social security taxes, a gross wage increase in excess of the rate of inflation is necessary merely for a person to stay even in terms of purchasing power.

D. *Recoupment*

As noted earlier, Mr. Henderson's computation of revenue deficiencies are contained in Appendix II. He was of the opinion that the most practical method of recovering the undercollection would be via a per unit charge over a twelve-month period of time. Staff did not voice an objection to this method of recoupment.

III. *CONCLUSION AND RECOMMENDATIONS*

By Opinion and Order issued April 23, 1979 the Commission authorized RG&E to file new tariffs designed to produce additional annual electric, street lighting and gas revenues (Cases 27370, 27371 and 27372, Opinion No. 79-12). Included in the approved wage and salary expenses in those proceedings were a level of wages resulting from increases during 1978. Thus, in the instant proceeding RG&E's entitlement should be limited to an amount no greater than the deficiency experienced between February, 1978 and April, 1979.[1]

Ordinarily the Commission is precluded from retroactive ratemaking. However, where the losses result due to no fault or acquiescence by the utility company and from rates fixed by public authority which are finally held to be inadequate, unjust or confiscatory, the rule prohibiting retroactive ratemaking is not applicable (*People ex rel. Pennsylvania Gas Co.* v. *P.S.C.*, 211 App. Div. 253, 267, Third Department, 1925; *United Gas Im-*

[1]Since the implementing tariffs in Cases 27370, 27371 and 27372 were not filed as of May 1, 1979, the Commission may wish to make provisions for a pro rata award for that portion of the May, 1979 expenses that are incurred before the new rates are put into effect.

provement Co. v. *Callery Properties, Inc.*, 382 U.S. 223, 229 (1925)). This precedent has been recognized by the Commission in past proceedings.

> "[T]he prohibition against retroactive ratemaking does not apply in circumstances where, as here, the rate sought to be adjusted has been set aside following judicial review." (Case 25668, *New Rochelle Water Company*, 12 NY PSC 1742, 1743 (1972)).

The Appellate Division's decision did not direct that a specific award be made in this proceeding but held, rather, that the Commission's refusal to grant a hearing as to the reasonableness of the wage increases was arbitrary. However, there is no evidence of record upon which to base a finding that the increased wage levels were unreasonable or that the amount of the deficit incurred was improperly calculated. Finally, it could be argued that, had the Commission granted a hearing and granted rate relief for the entire wage increase, the administrative process would have delayed implementation of the new rates. Undoubtedly such a procedure would have been expedited and in the absence of any basis for estimating the length of time such a process would have consumed, it is reasonable to conclude that the hearing process would not have materially affected the overall recovery.

Under the circumstances it is recommended that RG&E be permitted to file tariff revisions to recoup the deficit incurred from February, 1978 through April, 1979 as the result of the Commission's action in these proceedings with respect to wage and salary increases. The amounts to be recouped are $655,193 (electric exclusive of street lighting), $24,299 (street lighting) and $290,232 (gas). The Administrative Law Judge agrees with the Company that the most practical method of recovering the undercollection would be via a per unit charge over a twelve-month period of time.

May 7, 1979
VPF:bk

Appendix C

APPENDIX I

APPEARANCES
(In Original Proceeding)

Sigrid J. Hammond, Esq., Staff Counsel, Empire State Plaza, Agency Building No. 3, Albany, New York 12223, for Public Service Commission Staff.

Nixon, Hargrave, Devans & Doyle, Esqs. (by Richard N. George, Esq. and Walter J. Sleeth, Esq.), Lincoln First Tower, Rochester, New York 14604, for Rochester Gas and Electric Corporation.

Huber, Magill, Lawrence & Farrell, Esqs. (by Edward F. Huber, Esq. and Norman Abell, Esq.), 99 Park Avenue, New York, New York 10016, for Rochester Gas and Electric Corporation.

David A. Schlissel, Esq., 99 Washington Avenue, Albany, New York 12210, for State Consumer Protection Board.

Louis Kash, Corporation Counsel (by Francis Coleman, Esq. and Fred Balluff, Consultant), City Hall, Rochester, New York, for City of Rochester.

William L. Von Dohlen, Esq., 36 West Main Street, Rochester, New York, for Town of Greece.

Lloyd Lill, *et. al.*, 8 Prince Street, Rochester, New York 14607, for Genesee Valley People's Power Coalition.

DeGraff, Foy, Conway & Holt-Harris, Esqs. (by Algird F. White, Jr., Esq. and Terrence J. Devine, Esq.), 90 State Street, Albany, New York 12207, for Multiple Intervenors.

Appendix C

CASES 27108 and 27109

APPENDIX II

Rochester Gas and Electric Corporation
Revenue Requirement of 6% Wage and
Salary Increase Authorized by the Commission

	Total Company	Electric Department	Gas Department
Annual payroll per decision in Cases 27108 and 27109	$53,659,330[1]		
Payroll increases effective February 1, 1978 of 6%	3,219,560[1]		
Annual payroll at wage rates effective February 1, 1978	$56,878,890[1]		
79.84% applicable to operating expense	$45,412,106[1]		
Departmental operating expense (66.22%, 27.64%)[2]		$30,071,897	$12,551,096
Payroll allowed as of November, 1977 per decision in Cases 27108 and 27109		28,369,714	11,841,421
Payroll increase		$ 1,702,183	$ 710,485
Less adjustment to reflect labor productivity @ .73% of payroll		(219,525)	0
Adjusted payroll increase		$ 1,482,658	$ 710,485
Related welfare expenses			
Pensions		55,095	22,996
Life Insurance		39,556	16,510
Related payroll taxes		141,896	59,226
Total Increase		$1,719,205	$ 809,217
Revenue Requirement (@ 107.65%, 107.66%)		$1,850,726	$ 871,207

[1]including steam department.

[2]excluding steam department.

Appendix C

APPENDIX II, cont.

Rochester Gas and Electric Corporation
Revenue Requirement of 7.82%
February 1, 1978 Wage and Salary Increases

	Total Company	Electric Department	Gas Department
Annual payroll per decision in Cases 27108 and 27109	$53,659,330[1]		
Payroll increases effective February 1, 1978 of 7.82%	4,195,858[1]		
Annual payroll at wage rates effective February 1, 1978	$57,855,188[1]		
79.84% applicable to operating expense	$46,191,582[1]		
Departmental operating expense (66.22%, 27.64%)[2]		$30,588,066	$12,767,353
Payroll allowed as of November, 1977 per decision in Cases 27108 and 27109		28,369,714	11,841,421
Payroll increase		$ 2,218,352	$ 925,932
Less adjustment to reflect labor productivity @ .73% of payroll		(223,293)	0
Adjusted payroll increase		$ 1,995,059	$ 925,932
Related welfare expenses			
Pensions		55,095	22,996
Life Insurance		51,551	21,517
Related payroll taxes		145,152	60,585
Total Increase		$2,246,857	$ 1,031,030
Revenue Requirement (@ 107.65%, 107.66%)		$2,418,744	$ 1,110,012

[1]including steam department.

[2]excluding steam department.

Appendix C

CASES 27108 and 27109 Page 3 of 4

APPENDIX II, cont.

Rochester Gas and Electric Corporation
February 1, 1978 Wage and Salary Increase Data

	Electric Department	Gas Department
Revenue Requirement of Company 7.82% February 1, 1978 wage and salary increases (Page 2)	$ 2,418,744	$ 1,110,012
Revenue Requirement for 6% February 1, 1978 wage and salary increase authorized by the Commission (Page 1)	1,850,726	871,207
Difference	$ 568,018	$ 238,805
Operating expense wages prior to February 1, 1978 – Per Cases 27108 and 27109 (Page 2)	$28,369,714	$11,841,421
Operating expense wages after February 1, 1978 7.82% wage increase	$30,588,066	$12,767,353
1978 actual operating expense payroll reflecting 11 months of February, 1978 increase	$30,864,686	$12,946,981
Labor productivity reflected in Cases 27108 and 27109 prior to February 1, 1978 wage increase	$ 208,000	–
Labor productivity reflected in Company requested recovery of February, 1978 7.82% wage and salary increase	$ 223,293	–

Appendix C

CASES 27108 and 27109

APPENDIX II, cont.

Rochester Gas and Electric Corporation
Summary of Rate Increase Related to Payroll Adjustment
February 1978-May 1979

	Electric Department			
	Excluding St. Lighting	Street Lighting	Total	Gas Department
1978 Actual				
February	$ 3,763	$ —	$ 3,763	$ 15,683
March	37,748	1,728	39,476	31,499
April	45,499	1,725	47,224	22,861
May	43,872	1,844	45,716	16,133
June	45,622	1,624	47,246	8,402
July	46,590	1,731	48,321	6,719
August	47,910	1,734	49,644	6,458
September	47,104	1,734	48,838	6,702
October	46,151	1,721	47,872	10,975
November	45,471	1,732	47,203	15,972
December	48,114	1,743	49,857	25,025
1979 Actual				
January	51,325	1,742	53,067	34,586
February	50,991	1,738	52,729	36,476
March	48,298	1,748	50,046	29,083
1979 Forecast				
April	46,735	1,755	48,490	23,658
May	45,179	1,760	46,939	15,809
Total February 1978-May 1979	$700,372	$26,059	$726,431	$306,041

Appendix D
Order of the Court of Appeals of the State of New York, May 3, 1979

STATE OF NEW YORK
COURT OF APPEALS

At a session of the Court, held at Court of Appeals Hall in the City of Albany on the third day of May A.D. 1979

PRESENT, HON. LAWRENCE H. COOKE,
Chief Judge, presiding.

---

3 Mo. No. 456 SSD 39
In the Matter of Rochester Gas and Electric Corporation,
Appellant,

vs.

The Public Service Commission of the State of New York,
Respondent.

The appellant having filed notice of appeal in the above title and due consideration having been thereupon had, it is

ORDERED, that the appeal be and the same hereby is dismissed without costs, by the Court *sua sponte,* upon the ground that the order appealed from does not finally determine the proceeding within the meaning of the Constitution.

/S/ JOSEPH W. BELLACOSA
Clerk of the Court

Appendix E
Opinion of the New York Supreme Court,
Appellate Division, Third Judicial Department,
November 9, 1978

#33574

STATE OF NEW YORK **SUPREME COURT**
APPELLATE DIVISION **THIRD DEPARTMENT**

ROCHESTER GAS AND ELECTRIC CORPORATION,
Petitioner,

- against -

PUBLIC SERVICE COMMISSION,
Respondent.

Argued, September 14, 1978.

Before:

HON. T. PAUL KANE,
Justice Presiding,
HON. ROBERT G. MAIN,
HON. JOHN L. LARKIN
HON. ANN T. MIKOLL,
HON. J. CLARENCE HERLIHY,
Associate Justices.

PROCEEDING pursuant to CPLR article 78 (transferred to the Appellate Division of the Supreme Court in the Third Judicial Department by order of the Supreme Court at Special Term, entered in Albany County) to review determinations of the Public Service Commission which fixed rates for petitioner utility.

Appendix E

NIXON, HARGRAVE, DEVANS & DOYLE (Richard N. George of counsel), for petitioner, Lincoln First Tower, Rochester, New York 14603.

PETER H. SCHIFF (Sigrid J. Hammond of counsel), for respondent, Empire State Plaza, Albany, New York 12223.

ORDER FOR MODIFICATION

HERLIHY, J.

In this proceeding, Rochester Gas and Electric Corporation ("Rochester" or "the company") challenges the determination of the Public Service Commission (PSC), issued on November 1, 1977 and on January 20, 1978.

On December 3, 1976, Rochester filed proposed tariff revisions designed to increase electric revenues by about $20 million and gas revenues by $7 million. Public hearings on the proposed changes were conducted and following those hearings an Administrative Law Judge recommended the respective increases of $15,800,000 and $3,700,000 in electric and gas revenues. The PSC in its initial determination of November 1, 1977 reduced the proposed increases to the sums of $10,186,588 and $2,535,645 for electric and gas revenues. Further, the initial determination provided as follows:

> We shall permit RG&E [Rochester] to file tariff revisions to be effective in February, 1978 to recover actual increased wage and salary expenses that will become effective at that time, but, since the increase is not subject to collective bargaining, in no event will we allow an amount greater than the 6% increase estimated in this proceeding. We find this amount reasonable and the company can effectively preclude a higher increase from being paid. The company also will be required to provide evidence of labor productivity gains it expects to realize in the period during which the higher wage costs will be effective.

Appendix E

Rochester objected to the initial determination by seeking a rehearing on six issues. Three of the objections raised by Rochester are also the particular issues raised in this proceeding. *One* of these issues was phrased in part by Rochester in its objections as follows:

> The Company must take strong exception to the Commission having limited the allowable 1978 wage increase on the stated basis that "the increase is not subject to collective bargaining". This rationale is arbitrary and capricious, without basis in fact or in law. It amounts to imposing a penalty upon both the Company and its employees for the the fact that the Company is not unionized, and to an effort to coerce both the Company and its employees into becoming unionized. As such it constitutes an unpermitted interference with both the freedom of the Company's employees and the rights of Company management.

The PSC in its final determination, issued on January 20, 1978, denied a rehearing on any issue, but did revise its initial determination by allowing Rochester to include in its proposed rate filing an additional expense item of $120,000. On the question of wages, the PSC in this determination stated in part:

> Our decision to follow this procedure in no way affects the freedom of the company management or its employees with respect to labor relations and was clearly not intended to coerce the company and its employees to become unionized as RG&E contends. To repeat, we simply authorized RG&E to file revised tariffs in February, 1978 to recover its actual higher wage expense anticipated to become effective at that time, up to a level of increase that the company itself estimated in this proceeding.

As to the other issues, the PSC in its initial determination and its subsequent refusal of a rehearing applied its "policy" or guideline as to certain forms of advertising generally described as informational, and accordingly limited the allowable portion

of such expense to 0.1% of gross revenues. Further, the PSC disallowed a portion of test year expenses incurred for the hiring of outside contractors.

Rochester in its petition, briefs, and arguments in the proceeding before this court generally contends that in its ruling on the question of anticipated wage increases, informational advertising expenses and the expense for outside contractors, the PSC has acted arbitrarily and capriciously, irrationally, illegally, and/or dehors the facts established in the record.

I. The disallowance of wages in the present record and in particular the refusal to conduct a hearing on the reasonableness of the actual increase exceeding 6% was without any rational basis in the record and is arbitrary and capricious.

The details of the controversy as to wages are set forth hereinabove. The attempt of the Commission to distinguish between utilities involved in collective bargaining and those whose employees are not union members has no rational basis as evidence of future wage increases. Furthermore, the classification of the industry as to unions for the purpose of a prophecy of future wage increases would tend to encourage the employees to form or join unions as an inducement for management to grant larger wage increments. The PSC by its intrusion into the internal affairs of the utility in this particular case exceeds its power under the Public Service Law even though it attempted to modify or rectify the obvious reference to collective bargaining in its determination of January 20, 1978.

Furthermore, the record contained evidence that an increase of more than 6% was likely. The company pointed out that its 6% estimate was not truly based upon a forecast of actual wages, rather it was the same inflation rate which it had used in its proposed adjustments to escalate other components of expense to a probable 1978 cost level. As such, the estimate did not provide for merit increases. In this vein, the company's 2,012 weekly

employees were eligible for cost of living and merit increases, while the 632 monthly employees, although only entitled to merit increases, were granted raises equivalent to the total overall increase given weekly employees. Thus, there is evidence to indicate that a wage increase of more than 6% was the only reasonable conclusion.

Under such circumstances a refusal to permit a hearing as to the reasonableness of the actual increase, when a rate increase may not take effect until there is such an actual increase in wages, is arbitrary. (See e.g., *Matter of New York Tel. Co.* v. *Public Serv. Comm. of State of N.Y.*, ____ AD 2d ____ [Nov. 2, 1978].) As pointed out by Rochester:

> The law is well-settled that the Commission may not rely on a reckoning when actual experience is available and establishes that the predictions have been substantially incorrect (*Matter of New York Tel. Co.* v. *Public Serv. Comm. of State of N.Y.*, 29 N Y 2d 164, 169).

In regard to the wage increase, it should be noted that what, if any, expected labor productivity gains are properly required by the PSC to be considered in ascertaining the amount to be passed on to the consumer. The determination should be modified in accordance with the foregoing consideration of the wage increase.

II. In regard to the question of the amount of contractors' expenses to be allowed, it is noted that those expenses connected with the conversion of capital equipment in the gas distribution facilities as such need not be classified as incidental upkeep or operation of the business on an annual basis. There is no substantial foundation for the suggestion that the PSC erred in its treatment of this expenditure to the prejudice of the *petitioner*, and, accordingly, the determination on this issue should be confirmed as within the expertise of the PSC.

III. Rochester alleges several errors and/or illegalities as to the refusal of the PSC to allow more than $295,101 for anticipated information advertising expense. In its brief the company states that the advertising expense at issue is not related to promotional or commercial advertising. At the hearings held on this matter it was established that Rochester had for the test year, expenditures totaling about $780,000 which it allocates as follows: $258,524 for promoting the conservation of electricity and gas; $108,788 for promoting the safe use of its facilities and services; $87,276 for promoting information for individual customers as to obtaining and maintaining services; $71,544 for promoting "community" activities; $67,082 for advertising regarding the rising cost of energy; $180,491 for advertising general information about the company; and, $6,154 for promoting technical information for professionals and "do-it-yourselfers".

Rochester urges that recognizing the advertising as informational and not specifically designed to sell goods and services, it is within its right to freedom of speech and, therefore, the refusal to accept every penny so spent as a necessary expense for reimbursement violates the "First Amendment" except as such expenditures exceed the "limits of reason". In the case of *West Ohio Gas Co.* v. *Public Utilities Commission of Ohio* (294 U.S. 63, 72) the court observed that:

> Within the limits of reason, advertising or development expenses to foster normal growth are legitimate charges upon income for rate purposes as for others.

However, the reliance by petitioner upon the *West Ohio* case for its argument in regard to free speech is inappropriate as the court therein, per the Hon. Justice Cardoza, was not considering costs incurred in the simple dissemination of ideas or communications not designed to sell goods and services.

Appendix E

Assuming for present purposes that a corporate body or person has the full and complete protection of the constitutional right to freedom of speech unrelated to the immediate cultivation of profit and income in the matter of public service, or freedom of educating the public, as propaganda is often entitled, the present record discloses no interference with that right. It is established that the PSC has not in any way precluded Rochester from spending any monies it may desire so long as the stockholders do not object, thus, there is no *direct* prohibition or limitation on free speech. As to an indirect limitation, it is certain that the consumers are not concerned with such niceties as the image of a utility. The refusal to permit a direct reimbursement to a utility of expenditures of an informational character is not an indirect limitation because the burden imposed on the consumer in exchange for a monopoly to a utility is the obligation to reimburse the utility for reasonable operating expenses and this court has recently held that not all of promotional advertising must be charged to consumers (*Matter of Consolidated Edison Co. of N.Y.* v. *New York State Public Serv. Comm.* ____ A D 2d ____ [July 27, 1978]).

Upon the present record we find no infringement upon the freedom of speech of the company.

The company further contends that the refusal to allow the subject advertising expenses constituted a taking of its property without compensation. In turn, this alleged error requires consideration of whether or not there is evidence in the record to support the determination of the PSC as being upon a reasonable basis and not being arbitrary and capricious (see *Matter of County of Orange* v. *Public Serv. Comm. of State of N.Y.*, 37 N Y 2d 762, 765; *Matter of Legislature of County of Rockland* v. *New York State Pub. Serv. Comm.* 49 AD 2d 484, 487.)

The record discloses that the PSC in the course of regulating rates concluded that a piecemeal examination of each item of

informational advertising expenditure to determine its eligibility for reimbursement as being "reasonable" or "unreasonable" was too time consuming to be beneficial in its hearing, and, therefore, it adopted studies and promulgated guidelines which would establish that without particular examination, the maximum reasonable amount would be 0.1% of operating revenues.*

An examination of the record reveals that there was testimony on behalf of Rochester which segregated the expenditure for informational advertising according to the categories referred to

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*In its determination of January 20, 1978, the PSC described the situation as follows:

Advertising Expense

RG&E next takes issue with our decision to reduce allowable advertising expense from the $750,982 level incurred during the test year to $295,101, an amount which represents one-tenth of 1% of RG&E's operating revenues. The decision implements our policy of setting an allowance for informational and institutional advertising costs in accordance with certain guidelines established in our Advertising Policy Statement issued on February 25, 1977, in lieu of conducting an extensive and detailed review of advertising programs and expenditures in rate cases. We found, as we did several years before with respect to refined computations of working capital allowances,[1] that the time and expense of such studies had become wholly disproportionate to the benefits derived from close, individual examination and evaluation of the advertisements involved. Therefore, we announced our intention to forego individual examination of certain of these advertisements and, instead, to provide utilities in rate cases with a reasonable allowance for informational and institutional advertising, most probably ranging between one-tenth and one-twenty-fifth of 1% of operating revenues, in inverse relationship to the size of the company. We concluded, on the basis of the information available on the company's advertising program and factors such as the company's size, geographical location and number of customers, that RG&E's allowance should be established at the upper limit of the range we indicated to be proper in our policy statement.

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[1]Case 25342, *Consolidated Edison Company of New York, Inc.*, 10 NY PSC 434, 450-452 (1970); Case 26088, *Niagara Mohawk Power Corporation*, 11 NY PSC 1475, 1479-1482 (1971).

hereinabove as conservation, et cetera. However, there was no direct testimony as to each and every item in the grouping to show that the individual expenditures were "reasonable" or that the entire expenditure was reasonable. The PSC in its determination of January 20, 1978 construed the effect of that testimony as follows:

> RG&E [Rochester] also maintains that it satisfied its burden of proof as to the need for an advertising allowance equivalent to the amount it expended for that purpose in the test year. As we observed in our principal Opinion, however, RG&E's testimony on advertising is a litany of how and where it spent $755,982 on advertising in 1976 and concludes that an allowance within the Commission's Policy Statement range would be wholly inadequate. No effort was made to suggest why the test year level of expenditure was necessary and proper.

On an overall view of the record and applying the strictness of review necessarily applicable because the process of rate-making is a legislative function, not a judicial one, as the PSC is acting under authority delegated by the Legislature (*Matter of Public Serv. Comm. of State of N.Y.* v. *Norton*, 304 N.Y. 522, 530) it is apparent that the adoption by the PSC of a policy or rule whereby total expenditures in a general category would be "deemed reasonable" within certain objectively ascertainable limits is not arbitrary or capricious. The present record reveals that the PSC has surveyed the gas and electric utilities and by mathematical computation has determined an overall customary range within the group for the total of the subject expenditures. The accuracy of the range of expenditures as a guideline or test for policy purposes is within the expertise of the PSC and its conclusion that expenditures over such levels require justification is supported by factual evidence gathered by it. Under such circumstances the "policy" or regulation as to informational advertising expenditures is not lacking for a reasonable basis.

Further, the expenses involved in this category are all easily controlled by the management of utilities and are not of such a nature as to relate to the incidental sale of goods and services and thus, such expenditures are inherently discretionary in terms of the overall property of a utility. Accordingly, the adoption of a guideline whereby the industry itself is on notice that those expenses are expected not to exceed certain levels, as a matter of custom and experience, is reasonable regulation. It should be noted that Rochester had notice that the "policy" was being considered by the PSC for adoption as a guideline during much of the period of time when the subject expenditures were being made.

The "Statement of Policy" as issued by the PSC and applied to this proceeding recites that "parties in rate cases would still be free to question the propriety of the lump allowance for the informational and other institutional advertising categories". The Statement of Policy recites that in establishing the policy as to advertising, the PSC was considering that it was also its policy to "allow shareholders returns only at the minimum level necessary to attract capital".

The record as a whole demonstrates that in the present case it was not the "reasonableness" of the expenditure for advertising that was truly at issue, but rather the necessity. There can be no doubt that informational advertising in general has only a limited necessity. Rochester failed to demonstrate upon the present record anything other than the fact that certain expenditures were "allowable". Accordingly, the general presumption that expenditures of a utility are reasonable (cf. *West Ohio Gas Co.* v. *Public Utilities Commission of Ohio, supra*) was not sufficient to show necessity in view of the survey evidence obtained by the PSC as expressed in the policy.

Appendix E

Upon the present record the petitioner has not established a basis whereby this court can direct the PSC to include more of the informational advertising expenses than it did.

The determinations should be modified to the extent that the determination of November 1, 1977 setting a limit of 6% for future wage increases is annulled and to the extent that the determination of January 20, 1978 refusing a rehearing on the issue of a prospective wage increase is annulled; matter remitted to the Public Service Commission for further proceedings as to the appropriate allowance of a rate increase for the wage increase; and, as so modified, confirmed, without costs.

Appendix F
Order of the New York Supreme Court
Albany County, June 1, 1978

At an Ex Parte term of the Supreme Court, held in and for the County of Albany on the 1st day of June, 1978.

STATE OF NEW YORK
SUPREME COURT ALBANY COUNTY

ROCHESTER GAS AND ELECTRIC CORPORATION

Petitioner,

—vs—

THE PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK

Respondent.

ORDER

The Petitioner Rochester Gas and Electric Corporation having commenced this proceeding by petition dated May 18, 1978, pursuant to Article 78 of the Civil Practice Law and Rules, seeking an order annulling certain orders of the Public Service Commission dated November 1, 1977 and January 20, 1978, and further by Notice of Motion and Petition dated May 18, 1978, the Petitioner having moved this Court for an order transferring this proceeding to the Appellate Division, Third Department, for disposition of all issues, and upon the Petition verified on May 18, 1978, by John L. Kennedy, a Vice President of Petitioner, the affidavit of Richard N. George, Esq., sworn the 18th day of May, 1978, and upon the stipulation of the parties consenting to the transfer, dated June 1, 1978, it is hereby

ORDERED that this proceeding be and it hereby is transferred to the Appellate Division, Third Department for disposition of all issues.

Dated: 6/1/78

/s/ JOHN H. PENNOCK
J.S.C.

Appendix G
Order of the Public Service Commission of the State of New York Granting in Part and Denying in Part Petition for Rehearing, January 20, 1978

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

At a session of the Public Service Commission held in the City of Albany on January 17, 1978

COMMISSIONERS PRESENT:

Charles A. Zielinski, Acting Chairman
Carmel Carrington Marr
Harold A. Jerry, Jr.

CASE 27108 – ROCHESTER GAS AND ELECTRIC CORPORATION – Electric Rates

CASE 27109 – ROCHESTER GAS AND ELECTRIC CORPORATION – Gas Rates

ORDER GRANTING IN PART
AND DENYING IN PART
PETITION FOR REHEARING

(Issued January 20, 1978)

BY THE COMMISSION:

We issued Opinion No. 77-18 on November 1, 1977, determining the gas and electric revenue requirements of Rochester Gas and Electric Corporation (RG&E or "the company").

By application filed on November 30, 1977, the company seeks rehearing of our determination on six separate issues. The staff has filed a reply to RG&E's application urging that it be denied. For the reasons discussed in this Order, we find no sound reason for granting RG&E's application for rehearing on the six points it raises and, accordingly, we affirm our earlier decision on those

matters. We do find merit in RG&E's contention that an allowance should be provided to cover the cost of certain load studies we have directed it to undertake and, therefore, we make provision for recovery of a reasonable amount for that purpose.

Coal Stock Inventory

RG&E maintains that we erred in adopting a staff proposal to adjust downward RG&E's claimed working capital allowance for coal stock inventory, with a modification to account for an abnormality not reflected in the adjustment. Our decision was based upon record evidence which demonstrated that while RG&E claimed an inventory of 210,000 tons, it actually maintained, from 1973 to 1976, an average annual coal stock inventory that ranged between 161,441 tons to 197,972 tons. A staff engineering witness testified that the company had not maintained an average inventory of 210,000 tons for the past several years and that fossil generation estimated for 1977 and 1978 strongly indicated that the recent experience would be repeated in the period for which rates were being established. The staff witness advocated use of the 1974-1976 average inventory, 170,732 tons. We accepted staff's proposal as a point of departure, but adjusted it upward to 180,000 tons to reflect the fact that the abnormal outages at the Ginna station, which were not expected to recur, had not been taken into account by staff's witness.

RG&E points out that it maintained a 210,000-ton coal inventory some five years ago, in 1972, and "nearly achieved"[1] the 210,000-ton level in 1973 when it averaged a 197,972-ton level. The company contends that staff's forecast, which is based on more recent inventory experience, is deficient and devoid of useful and reliable information. RG&E also now claims to have maintained a six-month inventory of 208,112 tons from June to

[1]RG&E Application for Rehearing, p. 5.

November of 1977. But we do not believe that their latter extra-record contention warrants a change in our decision. Our result is based upon a year's average inventory. And, RG&E's six-month experience is not necessarily representative of a twelve-month average inventory.

Further, we find no other persuasive reason for changing our decision. Staff's adjustment, modified to account for the effect on coal inventory of the abnormal Ginna outages,[1] clearly represents a more reasonable projection of RG&E's prospective coal inventory than one based upon an annual target level that has been achieved, on average, only once in the last five years. We find the company's reasoning, which suggests that a target coal inventory level that has not been actually achieved since 1972 is more useful and reliable than one based on more current information, to be wholly unpersuasive.

RG&E also asserts that our decision to reflect the cost of maintaining a 180,000-ton coal inventory is tantamount to a determination that a higher level is not necessary and proper. We make no such determination. We simply find that the evidence adduced in this proceeding supports a finding that an average coal stock inventory of 180,000 tons can be expected to be achieved in the period for which we are setting rates.

Wage and Salaries

RG&E seeks rehearing of our decision to permit it to recover, as part of the rate increase allowed in this proceeding, a 6% wage increase the company projected will become effective in February, 1978.

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[1]While RG&E suggests that our modification is insufficient because it restores only 25% of the difference between staff's estimate and its claimed inventory level, it provides no basis for determining that some other figure would represent a better estimate of the effect on coal inventory of the Ginna outages.

Appendix G

The company's petition reflects a fundamental misunderstanding of our decision. It should be clearly understood that our determination authorizing it to file rates in February, 1978 to recover a wage increase in an amount up to 6% is part of the rate increase approved in the instant proceeding and not merely advance approval of a so-called "mini" rate case, *i.e.*, one not constituting a "major" rate change under Section 66(12) of the Public Service Law.

RG&E questions the basis for our decision to approve in advance rates designed to recover a wage increase up to the level that the company itself anticipated as part of its direct case in this proceeding. The company does not believe that the record provides a basis for a finding that advance approval of a wage increase up to 6% is reasonable. Of course, the basis is the company's own testimony and exhibits filed in this proceeding which projected a 6% wage increase to become effective in February, 1978. We found that the allowance for higher wages originally selected by RG&E was a reasonable estimate of increased labor costs that it would incur beginning February, 1978 and we made provision for recovery of the actual increase, up to a maximum of the estimated 6%. The record clearly contains no evidence that a higher wage increase would be reasonable or was anticipated at the time of our decision.[1, 2]

Our decision to follow this procedure in no way affects the freedom of the company management or its employees with

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[1]In fact, the record contains evidence, which we found to be insufficient, leading to precisely the opposite conclusion. See testimony of Consumer Protection Board's witness Rothschild and that introduced by intervenor Genesee Valley People's Power Coalition.

[2]By letter filed December 30, 1977, RG&E advises that an overall average 7.82% salary increase will become effective on February 1, 1978, a fact which does not change the record evidence upon which our decision was based.

respect to labor relations and was clearly not intended to coerce the company and its employees to become unionized, as RG&E contends. To repeat, we simply authorized RG&E to file revised tariffs in February, 1978 to recover its actual higher wage expense anticipated to become effective at that time, up to a level of increase that the company itself estimated in this proceeding.

Advertising Expense

RG&E next takes issue with our decision to reduce allowable advertising expense from the $750,982 level incurred during the test year to $295,101, an amount which represents one-tenth of 1% of RG&E's operating revenues. The decision implements our policy of setting an allowance for informational and institutional advertising costs in accordance with certain guidelines established in our Advertising Policy Statement issued on February 25, 1977, in lieu of conducting an extensive and detailed review of advertising programs and expenditures in rate cases. We found, as we did several years before with respect to refined computations of working capital allowances,[1] that the time and expense of such studies had become wholly disproportionate to the benefits derived from close, individual examination and evaluation of the advertisements involved. Therefore, we announced our intention to forego individual examination of certain of these advertisements and, instead, to provide utilities in rate cases with a reasonable allowance for informational and institutional advertising, most probably ranging between one-tenth and one-twenty-fifth of 1% of operating revenues, in inverse relationship to the size of the company. We concluded, on the basis of the information available on the company's advertising program and factors such

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[1]Case 25342, *Consolidated Edison Company of New York, Inc.*, 10 NY PSC 434, 450-452 (1970); Case 26088, *Niagara Mohawk Power Corporation*, 11 NY PSC 1475, 1479-1482 (1971).

as the company's size, geographical location and number of customers, that RG&E's allowance should be established at the upper limit of the range we indicated to be proper in our Policy Statement.

In its application for rehearing, the company objects to our decision to disallow any part of its test period advertising expenditures and to our asserted failure to include advertising expense in the computation of an escalation allowance. The company lists eight reasons in support of its contention that our decision is improper as a matter of law and public policy.

RG&E first complains that we have ignored the presumption of regularity which requires at least a *prima facie* rebuttal before a matter is put in issue and ignored what it describes as unchallenged evidence of the propriety of its test year level of advertising expense. We observed in our decision that the company's test year advertising costs were well in excess of the guideline limits set in our Policy Statement. Although RG&E repeatedly refers to the absence of evidence tending to rebut the propriety of its advertising expenditures, it chooses to ignore the testimony of two witnesses of intervenor Genesee Valley People's Power Coalition (GVPPC) that questions the need for the level of informational and institutional advertising incurred by the company,[1] as well as staff witness Rosenstrauch's adjustment deleting advertising costs in excess of one-twenty-fifth of 1% of operating revenues. Of course, the reason why staff did not examine the advertising expenditures of RG&E to ferret out specific disallowable programs and costs and why the particular items discussed by GVPPC were not evaluated was our announced decision to forego such unproductive, time consuming and costly review and to proceed by broadening the definition of

[1]One GVPPC witness questioned the need for specific RG&E advertising programs and advertisements as well as the overall level of advertising expenditures incurred by the company.

the kinds of advertising we would allow without question, but to determine in each rate proceeding, a percentage of revenues constituting the maximum we would allow.

RG&E also maintains that it satisfied its burden of proof as to the need for an advertising allowance equivalent to the amount it expended for that purpose in the test year. As we observed in our principal Opinion, however, RG&E's testimony on advertising is a litany of how and where it spent $755,982 on advertising in 1976 and concludes that an allowance within the Commission's Policy Statement range would be wholly inadequate. No effort was made to suggest why the test year level of expenditure was necessary and proper.

The company further contends that our decision interferes with its right to communicate with its customers and would require a reduction in desirable advertising programs. At the outset, it should be clearly understood that nothing in our Policy Statement or in our Opinion in this proceeding interferes with the company's right to communicate with its customers. Our action imposes a limit on the amount the company can recover from its ratepayers for that purpose; the company can spend more for advertising if it sees fit but the excess will be at the expense of the shareholders.

Our decision to allow RG&E $295,101 for informational and institutional advertising expenditures recognizes the desirability of, *inter alia*, conservation and safety related advertising programs. RG&E's extensive efforts in these areas was one of the reasons for our decision to grant it an allowance at the top of the range we established in our Policy Statement. The amount we have provided for advertising expenditures in this case — the highest percentage of revenues we have allowed any utility since application of the principles set forth in our Policy Statement — constitutes a reasonable allowance for such costs that can be expected to be incurred in the period for which we are setting rates.

Appendix G

Conversion Expenses

We decided to amortize, over a three-year period, $147,300 of nonrecurring expenses in the test year that RG&E incurred for conversion from manufactured to natural gas. The company claims that our decision is arbitrary and capricious and constitutes a taking of property without due process. Staff, objecting to our decision to amortize the expense, claims that the full $147,300 should have been disallowed.

RG&E observes that, in a previous rate case, we adopted without comment a recommendation of the Hearing Examiner that conversion expenses not be amortized because they were not unusual or distortive. In the instant case, however, staff identified a specific level of contractor expense as nonrecurring and litigated the issue on exceptions. We declined to accept staff's position that the nonrecurring nature of this particular expense rendered it disallowable because of the prospect that expenses of similar magnitude would be incurred in the future. Our decision to amortize the amount for ratemaking purposes is not inconsistent with that determination, as RG&E contends; it merely reflects our conclusion that an allowance of one-third of $147,300, or $49,100, was a reasonable estimate of the level of such future expenses that would be incurred in the first year of new rates. We find no sound reason for changing our decision in this respect.

Rate of Return

RG&E begins its appeal from our rate of return determination with a contention that the allowed 12.8% return on equity is "bare bones and minimal." It further asserts that the company's historic failure to achieve the allowed return will continue, in part because inadequate attention has been paid to selection of a proper return. Finally, the company specifically questions our reliance on a 5.4% growth component in the DCF computation,

an amount within the range recommended by staff's expert witness.

The return on equity we allowed RG&E in this proceeding is minimal, as RG&E suggests; but it is the minimum return that will permit the company to compete successfully with other investment opportunities in attracting new equity capital. It is not an unadjusted "bare bones" return; it includes a reasonable premium to assure the company's ability to raise capital without diluting its book value. Moreover, we have taken adequate steps in this proceeding, including the grant of substantial allowances to offset future inflation and attrition, to provide every reasonable assurance that RG&E will earn the allowed return.

With respect to our reliance on a 5.4% growth rate in the DCF computation, we found staff's analysis more reliable than the alternative offered by RG&E. Staff's recommended growth component was based upon a study of RG&E's growth from plowback of current earnings in 1976 of 5.0% and was corroborated by longer term studies of the company's growth in book value and dividends. The company's approach to growth, which relies upon an analysis of 1974-1976 growth in earnings and dividends per share is unsound because the data upon which it relies were distorted by very low earned returns in 1974 and 1975. Staff's approach, on the other hand, employs longer term analyses that correct for the atypicality of the shorter term results. Moreover, staff has not exclusively relied upon the longer term averages to justify its recommended 5.0% to 5.4% growth range. Specifically, staff's witness recognized that the growth rate must consider current as well as historical earnings. To satisfy this requirement, staff observed that, in 1976, RG&E had growth from the plowback of current earnings of 5.0%. Because it was probable that some investors would expect RG&E's earnings to increase in 1977, staff's testimony concludes that internal growth in book value can reasonably be expected to reach 5.4%.

In sum, we find no basis for modifying the rate of return determination reached in our principal Opinion in this proceeding.[1]

Load Studies

RG&E seeks rehearing of our decision requiring it to conduct a new load study in S.C. No. 2 and studies of high and low use customers in S.C. No. 1 within two years of the date of our Order. We have reviewed the points made by the company seeking relief from this requirement and find them unpersuasive. That the company has an ongoing load study program and is in the process of conducting load studies in some service classifications is not a sufficient answer to our concerns about the reliability of load data currently available, particularly with respect to S.C. No. 2 where the most current load data are over 11 years old. The studies suggested by staff are reasonable and necessary prerequisites for development and implementation of rate structure changes designed to reflect more closely the cost of serving particular customers.

However, we believe that the company should be compensated for the expense of undertaking these load studies and would have provided such compensation in our original Order if we had a reasonable estimate of the expense. Accordingly, we shall authorize the company to include $120,000 – the estimate it has now provided of the expense of complying with our directive – as part of the rate change that will be made in February, 1978 to reflect the company's higher wage costs.

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[1]In staff's reply to RG&E's petition for rehearing, it points out that, subsequent to issuance of our Opinion in this proceeding, RG&E issued $28 million of preferred stock at 7.6% to replace $25 million of 11% preferred stock. Staff seeks to adjust downward the overall rate of return allowed in this proceeding to reflect the financing change. We reject staff's suggestion because it is not properly the subject of a petition for rehearing.

Appendix G

The Commission orders:

1. The application for rehearing on behalf of Rochester Gas and Electric Corporation filed November 30, 1977 in this proceeding is, except as specifically noted in this Order, denied.

2. Rochester Gas and Electric Corporation is authorized to include, in its February, 1978 filing to recover higher wage costs, an additional $120,000 to recover the cost of conducting load studies directed in our principal Opinion and Order.

3. This proceeding is continued.

By the Commission,

(SEAL) (SIGNED) SAMUEL R. MADISON
Secretary

Appendix H
Opinion of the Public Service Commission of the State of New York, November 1, 1977

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

OPINION NO. 77-18

CASE 27108 – ROCHESTER GAS AND ELECTRIC CORPORATION – Electric Rates

CASE 27109 – ROCHESTER GAS AND ELECTRIC CORPORATION – Gas Rates

OPINION AND ORDER
DETERMINING REVENUE REQUIREMENT

Issued: November 1, 1977

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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

APPEARANCES

Sigrid J. Hammon, Esq., Staff Counsel, Empire State Plaza, Agency Building No. 3, Albany, New York, for Public Service Commission Staff.

Nixon, Hargrave, Devans & Doyle, Esq. (by Richard N. George, Esq. and Walter J. Sleeth, Esq.), Lincoln First Tower, Rochester, New York 14604, for Rochester Gas and Electric Corporation.

Huber, Magill, Lawrence & Farrell, Esqs. (by Edward F. Huber, Esq. and Norman Abell, Esq.), 99 Park Avenue, New York 10016, for Rochester Gas and Electric Corporation.

David A. Schlissel, Esq., 99 Washington Avenue, Albany, New York 12210, for State Consumer Protection Board.

Louis Kash, Corporation Counsel (by Francis Coleman, Esq. and Fred Balluff, Consultant), City Hall, Rochester, New York, for City of Rochester.

William L. Von Dohlen, Esq., 36 West Main Street, Rochester, New York, for Town of Greece.

Lloyd Lill, *et al.*, 8 Prince Street, Rochester, New York 14607, for Genesee Valley People's Power Coalition.

DeGraff, Foy, Conway & Holt-Harris, Esqs. (by Algird F. White, Jr., Esq. and Terrence J. Devine, Esq.), 90 State Street, Albany, New York 12207, for Multiple Intervenors.

Appendix H

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

COMMISSIONERS:

Charles A. Zielinski, Acting Chairman
Harold A. Jerry, Jr.
Anne F. Mead

CASE 27108 – ROCHESTER GAS AND ELECTRIC CORPORATION – Electric Rates

CASE 27109 – ROCHESTER GAS AND ELECTRIC CORPORATION – Gas Rates

OPINION NO. 77-18

OPINION AND ORDER
DETERMINING REVENUE REQUIREMENT

(Issued November 1, 1977)

BY THE COMMISSION:

On December 3, 1976, Rochester Gas and Electric Corporation ("RG&E" or "the company") filed tariffs designed to produce an increase in annual electric revenues of $20,095,900 and an increase in gas revenues of $6,997,500 on the basis of estimated sales in 1976. The proposed rates have been suspended by the Commission through November 2, 1977.[1]

Administrative Law Judge Walter T. Moynihan issued an initial decision on August 17, 1977 in which he recommended that RG&E be allowed to increase its electric rates to recoup an additional $15.8 million in annual revenues and its gas rates to yield an additional $3.7 million in annual revenues. Briefs on

[1]On January 21, 1977, RG&E filed a new schedule for electric street lighting service. That proposal has been suspended through January 12, 1978 and will be handled in a separate phase of Case 27108.

exceptions to his recommendations have been received from the company, staff, the City of Rochester and Genesee Valley People's Power Coalition (Genesee). The issues in dispute cover a wide range of subjects because the parties have chosen to continue to litigate virtually all of the issues that were before the Administrative Law Judge.

TEST YEAR AND ATTRITION

The company's case was tried on the basis of a calendar 1976 test year. When RG&E's direct case was filed, we ordered the company to submit operating projections for 1977 and 1978 because of the absence of information in its initial filing on conditions likely to be encountered in the period for which rates were being set. The company provided the forecast material within the time required.

It is the company's projections for 1977 and 1978 that form the basis for its request for an attrition allowance equal to almost 1% of rate base in the electric department. The company claims that an additional return factor to account for attrition is required because its electric rate base is expected to increase at a much faster rate than available earnings.[1] Although proceeding to discuss and resolve all of the issues that relate to the 1976 test period, Judge Moynihan in fact resolved the case by relying on the 1978 projections submitted by the company because he allowed an attrition adjustment equal to the difference in return requirements indicated by the 1976 and 1978 periods. He allowed RG&E an additional return allowance of .81% to compensate for the difference between the 1976 test year data as adjusted for his findings and the 1978 forecast, similarly adjusted. This allowance constitutes over $6.6 million, or 42%, of the $15.8 million recommmended additional electric revenue requirement.

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[1]RG&E projects a 17% increase in electric rate base from 1976 to 1978.

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Judge Moynihan made several adjustments to the company's 1978 forecasts: (1) to reduce rate base to reflect earnings base in excess of capitalization and to remove Sterling-related projects from 1978 plant in service;[1] (2) to reduce projected 1978 expenses to equal the observed 1976 experience times the proper escalation factor; (3) to remove an amount for a wage increase expected to become effective February 1, 1978, in view of a recommendation that any such wage increase be allowed in a second-step filing; (4) to reduce the allowance so that it will cover only the first 12 months of newly effective rates.

Because the company itself did not rely fully upon its projected data, staff did not present a total analysis of projected attrition facing RG&E and utilized the forecasts of 1977 and 1978 experience instead to adjust selectively components of the forecasts that it believed required adjustment. Staff argues that there is no legal basis to grant an attrition allowance because the company did not request one in its original filing and because the forecasts submitted by RG&E were too speculative to permit any allowance for expected attrition.

It is true that the company's forecasts appear to have been hurriedly prepared in order to satisfy our requirement that they be filed within 30 days of the order directing submission of this material. It is also true that RG&E's request for an attrition allowance was not part of its original rate increase request and that its arguments for the allowance are not based upon a claim that the forecasts are reliable. The company now justifies the requested attrition allowance on general conceptual grounds such as its repeated inability to earn the return allowed by the

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[1]Sterling refers to the proposed Sterling-SNUPPS nuclear generating facility which is currently before the State Board on Electric Generation Siting and the Environment for certification under Article VIII of the Public Service Law.

Commission, and that its rate base growth is outstripping growth in earnings.

The company has, in its reply brief on exceptions, argued in support of the reliability of its forecast data; but we find that the acceptability of those forecasts for the purposes of computing an accurate attrition allowance was seriously undermined by staff's testimony and arguments on brief. For example, staff observes that the company's forecast of rate base included no information on in-service dates of expected additions, no explanation of why many of the forecast plant additions are necessary and that no consideration was given to potential slippages.[1] Staff also pointed out that it was unable to determine what assumptions were built into the company's projections in other categories of its forecasts.

The forecasts submitted in this proceeding at our request are at least as deficient and devoid of useful and reliable information as those which we had occasion to examine but three weeks ago in Cases 27103 and 27104, *New York State Electric & Gas Corporation* (Opinion No. 77-16, issued October 17, 1977). Our inability to trace and verify elements of the forecast and the absence of a discernible link to historical data render the forecasts submitted in the instant proceeding unacceptable for use as a test year, or for the development of an accurate attrition allowance. We conclude that the forecasts can only be used as a general guide for determining, on an order of magnitude basis, what conditions are likely to be experienced by RG&E in the first year of new rates.

Examining RG&E's forecasts with this in mind, it becomes quite clear that staff's approach to the subject of attrition does not constitute a constructive alternative to the company's position. It is obvious that the company expects to add

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[1]More detailed plant addition forecasts were introduced in rebuttal.

significant amounts to plant in service in 1977 and 1978 without a concomitant increase in earnings. While good cause exists for treating skeptically the precise figures projected by RG&E, it is clear that the company's rate base will grow at a rate that exceeds anticipated growth in income. Faced with these circumstances, it is simply unconstructive to argue, as staff has chosen to in this case, that there is no basis for the grant of an allowance to offset the effects of capital attrition.

We have expressed in past cases our preference for treating the subject of attrition on a total case basis where anticipated changes in each of the elements affecting attrition, such as sales, rate base and expenses are analyzed in relation to each other for the first 12 months of newly effective rates.[1] If reasonably reliable, traceable and verifiable projections are available for these elements of the cost of service for the pertinent rate setting period, they can be compared with the results indicated by the historical data to ascertain the amount required, if any, to offset attrition. Where reasonably complete projections are either unreliable or unavailable, we have employed other techniques to determine reasonable allowances for capital attrition, such as the recognition for ratemaking purposes of specifically identifiable post-test year nonincome producing additions to rate base, or the grant of an additional return factor calculated roughly to offset expected attrition.[2] In view of the apparent poor quality of the forecasts introduced in this proceeding, we find it necessary to use the less precise and more judgmental approach suggested in the latter line of cases.

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[1]Cases 26848, 26849, *Rochester Gas and Electric Corporation* (Opinion No. 76-8, issued April 8, 1976, mimeo at pages 14-15), Case 26552, *Long Island Lighting Company*, 15 NY PSC 15, 29 (1975).

[2]Cases 26763 and 26764, *New York State Electric & Gas Corporation*, 15 NY PSC 1564 (1975), Case 26538, *Consolidated Edison Company of New York, Inc.*, 14 NY PSC 1503 (1974).

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It is uncontested in the record that RG&E will add at least $21.6 million in nonincome producing plant to rate base from the end of the 1976 test year through 1978. The specific items covered by this amount are changes at Ginna directed by the Nuclear Regulatory Commission and water chemistry modifications at that plant performed by Westinghouse. While much of the rate base additions contained in the company's forecasts were contested by staff, either in amount or expected date of completion, it is virtually certain that the high energy modifications and the volatile water system changes which make up the $21.6 million figure cited above will be completed by the end of 1977. We will, accordingly, use this amount, as an adjustment to rate base, as a surrogate for an attrition allowance in this proceeding on the theory that increased sales may be expected to offset any diminution in earnings caused by revenue producing plant additions contemplated in this period, while nonrevenue producing items such as those discussed here can be expected to have no such offsetting effect.[1] In addition to recognition of this amount of post-test year nonincome producing plant in rate base, we shall, consistent with our policy, take into account all expected changes in operations that are reasonably certain to occur in the first year of new rates. We expect to soon issue guidelines for the submission of forecast information in rate cases which can be expected to provide a sounder basis for computing accurate allowances to account fully for conditions in the period for which rates are being set. They

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[1]Because our rate base adjustment is meant to be a surrogate for a more precise attrition allowance, we will not reflect the kind of routine, consequential effects, such as those for projected retirements, depreciation accruals, net salvage, deferred investment tax credits, deferred Federal income tax and property taxes that we normally make when recognizing such additions. These offsets will continue to be reflected in cases where specific recognition is given in rate base to post-test year plant additions. See Cases 27094 and 27095 – *Orange and Rockland Utilities, Inc.* (Opinion No. 77-14, issued October 7, 1977, mimeo at pp. 13-14).

should, in any event, serve to prevent a recurrence of the unacceptable forecast presentations offered in this case and in *New York State, supra.*

ELECTRIC AND GAS REVENUE REQUIREMENT ISSUES

Gas Sales — Purchased Gas Curtailment Adjustment

RG&E proposed to reduce calendar 1976 Gas Department revenues to reflect an expected reduction in gas sales during the first year of new rates. The adjustment was calculated to assume loss of revenues associated with sales to those customers required to have alternate fuel capability as a precondition for receiving gas service and overruns associated with customers subject to annual consumption limitations. Judge Moynihan accepted the company's adjustment but, as is clear from a reading of the recommended decision, he was under the misapprehension that the company was in fact curtailing alternate fuel customers and was still maintaining overrun limitations on its so-called Rule 2.64 customers. Since those conditions are not in effect at this time, the company assumes that Judge Moynihan meant to reject the proposed adjustment and it therefore excepts.

The company argues that although its gas supply picture has improved considerably over the past year, and even though it now expects that it will be able to supply all of its customers in 1978, this adjustment should still be applied because it claims that it is uncertain whether its customers will purchase as much gas in 1978 as they did in 1976. The company points to conservation, and the fact that it has fewer gas customers than it did in the test period, as factors that would reduce gas sales in the first year of new rates.

Staff observes that the company filed tariff revisions on September 2, 1977 to allow attachment of new gas customers. It

submitted a sales forecast at that time which shows decreased requirements in 1978 and increases thereafter. Staff argues that the decrease in sales shown was not supported and, in any event, amounts to a mere 285,000 Mcf reduction, an amount which would not justify allowance of any adjustment for reduced sales.

At the time of the company's rate filing, it seemed true that the 1976 level of gas sales would not be a good approximation of expected sales in 1978 since the evidence indicated that RG&E had fewer gas customers than it did in 1976 and that each of those customers, on the average, was using less gas. A countervailing consideration has emerged however: the company's petition to add new gas customers. That petition, which we have decided will be approved, can reasonably be expected to offset the decline in customers and gas usage per customer since the end of 1976. This is particularly true in this case because RG&E will be allowed to attach not only new residential customers but individually metered commercial and industrial customers with a maximum usage of 1,200 Mcf per year, process use customers without feasible alternate fuel capability, and dual-fuel customers. In addition, provision has been made to permit 20% overruns of the highest use year between 1969-1975 for existing customers. Under these circumstances, we believe staff's position that no downward sales adjustment is required should be adopted.

Working Capital — Coal Inventory

The company claimed a working capital allowance for coal inventory on the basis of 210,000 tons of coal, an amount which it expects to maintain in the future. Because RG&E's historical experience indicated that this level represented an unrealistic goal which has not been achieved in the past three years, staff proposed an adjustment to reduce coal stock and coal in transit to the average historical levels of the past three years. Judge

Moynihan rejected staff's proposed adjustment on the ground that the company should not be penalized for relying on a stockpile to carry it through emergencies. The Judge's theory is that the existence of emergencies such as oil embargos and major plant outages required RG&E to reduce its inventory and that it would be unfair to reflect the consequent reduction in coal stockpile for ratemaking purposes in this case.

The question of penalty raised by the Administrative Law Judge really is not responsive to the issue presented by staff, which is: what amount of coal inventory is it reasonable to expect that RG&E will maintain during the rate year? Staff has provided a sound reason for questioning whether the 210,000-ton goal of RG&E will be realized on average. The company contends that acceptance of staff's adjustment will represent a determination by the Commission that a lesser coal inventory, specifically 170,732 tons, is an adequate reserve for the company.

Of course, adoption of staff's figure as the best available estimate of the average 1978 coal inventory is not necessarily a determination that a reserve below 210,000 tons is considered adequate. The company claims to have achieved a coal stock of 209,000 tons in its monthly operating report as of August 31, 1977. That the company has succeeded in reaching its inventory goal is, however, not dispositive of this issue for it appears that its coal inventory has rarely exceeded the 210,000 ton goal. Experience demonstrates that the company's inventory goal is not an average level sought to be maintained where overruns and underruns are commonplace. It appears, instead, to be a maximum level which, when reached, is drawn down when necessary. In these circumstances, an historical average inventory, such as that suggested by staff, can be expected to match more closely actual experience in the first year of new rates than the inventory goal of 210,000 tons. We believe, however, that staff's adjustment requires an upward

modification because the recent historical experience reflects abnormal outages at the Ginna station. Use of an unadjusted historical average would be tantamount to predicting a recurrence of these events in the first year of new rates. Since there is no basis for such a projection, we will increase staff's coal inventory to 180,000 tons, an amount that we believe will more accurately reflect the expected coal inventory level that will, on average, be maintained during 1978.

Ginna Rotor Investment Tax Credit

Judge Moynihan rejected a staff adjustment which imputes to the company the investment tax credit associated with the planned installation of a new rotor at the Ginna station on the grounds that the company will not be able to utilize the credits in the period for which rates are being set. Staff admits that the company's expected tax position in 1978 will not permit it to use the investment tax credit associated with the Ginna rotor. Staff nevertheless argues that the benefits of the investment tax credit should be captured for ratemaking purposes since it is consistent with the other Ginna normalization adjustments adopted by Judge Moynihan.

RG&E observes that part of the reason for its inability to use the Ginna rotor investment tax credit relates to its election of progress payment investment tax credit, a course of action which the Commission encouraged the company to follow in its last rate case. The company argues that it would be particularly unfair now to penalize it by imputing investment tax credit benefits which it cannot realize in the ratemaking year in light of the Commission's stance on this issue in the company's last rate case.

Because all usable investment tax credits have been reflected in the Administrative Law Judge's decision, we find no basis for imputing additional benefits merely for the sake of consistency

with other Ginna normalization adjustments. We affirm the Judge's recommendation and deny staff's exception.

Interperiod Tax Allocation

Because of RG&E's anticipated high ratio of AFC to common equity earnings (over 40% in 1978), the company proposed and staff agreed that it should be permitted to accrue AFC[1] net of taxes for its participation in Oswego No. 6 and Nine Mile Point No. 2. RG&E proposes, however, to normalize not only the tax deduction benefits derived from interest on the debt used to finance these projects but also the tax benefits of property, sales and use taxes. Staff recommends that the interperiod tax allocation applicable to the debt component of AFC be granted and that the proposed allocation of real property tax, sales and use taxes be rejected.

The company contends that its proposal is a logical extension of our policy with respect to interperiod tax allocation for interest deductions, in that it would merely cover other well recognized tax consequences of identifiable construction work in progress. RG&E observes that the logic for approving the charging of AFC net of taxes was to give future ratepayers the benefits of tax deductions related to construction. The company contends that once it has been decided that current ratepayers should not enjoy the benefit of reduced Federal income tax expense related to tax deductible capitalized interest on future plants, it logically follows that reduced Federal income tax expense related to capitalized property, sales and use taxes pertaining to that plant also should not be enjoyed by current ratepayers.

Staff opposes the extension of the interperiod tax allocation to cover capitalized real property, sales and use taxes because it

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[1]AFC is an acronym for allowance for funds used during construction.

will have a minimal effect on the company's AFC to earnings ratio, coverage and cash flow.

In several recent cases, we have sanctioned the charging of AFC net of Federal income tax[1] where it appeared that some measures, in addition to revenue allowances designed to offset expected capital attrition and earnings erosion, were required to improve cash flow for interest coverage purposes. This so-called interperiod tax allocation represented a departure from our normal practice of flowing through to current ratepayers the full amount of currently available tax benefits. In those cases, cash flow and coverage improvements were required primarily because of large, ongoing construction programs required to meet the need for additional capacity. In such circumstances, where an extraordinary measure was required to meet an extraordinary problem, the interperiod tax allocation made good sense because, under this procedure, future customers who will be required to bear the burden of the interest charges incurred during construction would receive the tax benefits associated with those interest deductions. In this case, there is no dispute between staff and the company that at least the tax benefits attributable to the tax deductible portion of AFC for the Nine Mile Point No. 2 and Oswego No. 6 generating units should be reserved for future ratepayers in order to improve RG&E's cash flow and interest coverage.

We agree with RG&E and staff that the company's large future construction program, which will require it to raise approximately $300 million of external capital from 1976

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[1]Case 26887, *Long Island Lighting Company* (Opinion No. 76-11, issued May 28, 1976), and Case 26943, *Niagara Mohawk Power Corporation* (Opinion No. 76-23, issued November 16, 1976). See also Cases 27103 and 27104, *New York State Electric & Gas Corporation* (Opinion No. 77-16, issued October 17, 1977. Charging AFC net of taxes involves reducing the AFC that is accumulating on work under construction by the income tax savings that the interest component of that AFC is making possible.

through 1978, and its high anticipated ratio of AFC to common earnings, expected to be over 40% in 1978, meet the criteria we have established for application of exceptional measures to improve cash flow and interest coverage. We disagree with RG&E's contention, however, that it should be allowed to go beyond accrual of AFC net of taxes for its participation in Oswego No. 6 and Nine Mile Point No. 2. While the company is correct that normalization of tax deduction benefits derived from property sales and use taxes is a logical consequence of a decision that current ratepayers should not enjoy the benefit of reduced Federal income tax expense pertaining to plant under construction, the company has failed to justify such an extension in this case on the grounds set forth in our previous decisions. It is clear that an extension of this extraordinary remedy to cover capitalized real property, sales and use taxes will have a minimal effect on the company's cash flow, coverage and AFC to earnings ratio. Since improvements in these areas has constituted the principal reason for our previous decisions to sanction the charging of AFC net of Federal income tax, there is no persuasive reason here for going beyond the boundaries of the extraordinary remedy that we fashioned in *LILCO* and *Niagara Mohawk*. We therefore reject RG&E's proposal, but will permit the company to accrue AFC net of Federal income taxes only for its participation in the Nine Mile Point No. 2 and Oswego No. 6 generating units.

Wages and Salaries

The company anticipates that it will incur a 6% increase in wage and salary expense on February 1, 1978. Judge Moynihan recommended that RG&E be permitted now to file tariff changes designed to recoup additional wage and salary expenses when they become known.

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CPB presented evidence and offered argument before Judge Moynihan to the effect that RG&E's electric labor costs were unreasonably high. Genesee also presented a wage comparison ansalysis which supported CPB's position. Judge Moynihan rejected these contentions in light of the deficiencies in the studies pointed out by RG&E. CPB has not excepted to Judge Moynihan's conclusions and Genesee's brief on exceptions raises no substantive arguments on this issue. We do not believe that this record provides a sufficient basis to support nonrecognition of current wage and salary expenses or increases anticipated in the period for which we are setting rates. We shall permit RG&E to file tariff revisions to be effective in February, 1978 to recover actual increased wage and salary expenses that will become effective at that time, but, since the increase is not subject to collective bargaining, in no event will we allow an amount greater than the 6% increase estimated in this proceeding. We find this amount reasonable and the company can effectively preclude a higher increase from being paid. The company also will be required to provide evidence of labor productivity gains it expects to realize in the period during which the higher wage costs will be effective.

Property Taxes and Post-Record Changes

In its reply brief on exceptions, the company requested recognition of several post-record known changes in property taxes, payroll taxes and PSC assessments. Staff has verified all but a small amount of the requested changes in property taxes; but contends that the company's eleventh-hour submittal of these data violates our policy of recognizing such changes up until the filing of briefs on exceptions.[1]

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[1]Case 25448, *Brooklyn Union Gas Company*, 10 NY PSC 735 (1970).

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We shall allow all of the post-record changes requested by the company that have been verified by staff. The purpose of the time limitation established in *Brooklyn Union,* which is to permit staff and other parties an opportunity to review and comment on such changes, has been served in this case as is clear from staff's letter of October 13, 1977. Consistent with this policy, we shall recognize only those changes that have been verified and are uncontested at this time.

The company also submitted an estimate of the increase in property tax expense that it expects to incur in 1978, which reflects city, town and county, school and village taxes that will be booked beginning in January, 1978, but for the most part not billed until later times during the year. We will permit RG&E to include the estimated 1978 property tax increases as part of its February 1, 1978 supplemental filing, subject to refund and possible later adjustment if the actual increases are significantly less than the estimated amount.[1] Because of the lag between the date of booking and the effective date of rates to recover the higher property taxes, we will not require our customary 10% offset of the amount attributable to higher assessments.

Productivity

The company has excepted to the Administrative Law Judge's recognition of a productivity adjustment proposed by staff in developing income available for common in 1976. Staff observes that the Judge's acceptance of the company's 1978 forecast, which he mathematically translated into an additional return allowance to the 1976 test period, effectively moots any question

[1]The company should file in November, 1978, a reconciliation between the amount of additional revenue sought in its filing in early 1978 and the amount properly chargeable under its present accounting procedure between the effective dates of new rates to recover the additional property taxes and the effective date of any required adjustment.

with respect to the amount of productivity to be applied to the 1976 test year because the entire discrepancy found between the adjusted 1976 test year and the forecast 1978 test year has, under his treatment, been allowed as an attrition adjustment. Our decision not to follow the Judge's recommendation on attrition requires that we decide the productivity issue raised in the case.

Three productivity studies were introduced into the record of this proceeding. RG&E's study was a specific improvement analysis which concluded that it would realize savings of $127,600 for the Electric Department and $100,000 for the Gas Department as a result of delineated improvements in productivity.[1] The company reflected these amounts in both the historical and forecast test periods. Staff introduced a labor productivity adjustment which is designed to capture anticipated savings in labor expense as compared with sales for 1977. Staff's labor expense adjustment, $208,000, was computed by dividing 1977 labor expenses by the ratio of 1977 to 1976 sales. The adjustment implicitly assumes that per unit labor costs will decrease in the period analyzed. The CPB, which participated in this proceeding by introducing evidence on productivity and offering specific adjustments, has not filed a brief on exceptions to Judge Moynihan's decision. Nevertheless, it bears noting that the Board introduced a total factor productivity (TFP) analysis which found a TFP rate of 2.25% for the period 1964 through 1976, as adjusted to remove an atypical year, 1970, when the Ginna nuclear plant first came on line.

The CPB's total factor productivity analysis was criticized by staff in that it accorded the same weight to sales for resale as it did for other sales. Staff correctly observes that without proper weighting, the significant difference in costs associated with

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[1]These improvements do not reflect anticipated labor productivity gains.

each type of sales are not properly charged, which results in a distortion in the observed results.

The company claims that recognition of its specific productivity improvemen' - is all that reasonably need be done in this case. It suggests that it is improper to assume a reduction in the per unit cost of a kWh sold without attributing the cost savings to a specific source. The company fails to recognize, however, that, in light of evidence of continuing historical improvements in labor productivity, a failure to reflect such savings for the rate setting period would be tantamount to concluding that gains in labor productivity are not anticipated to continue. Staff's productivity adjustment represents the best attempt presented in this proceeding to measure labor productivity gains that may be expected to be realized in the post-test year period and will be adopted.[1]

Advertising

RG&E expended $755,982 during 1976 for advertising. This amount is well in excess of the range of reasonable advertising costs established in our Policy Statement on Advertising issued in February of this year. The lower and upper limits of that range for RG&E would be $122,200 and $308,000.

Judge Moynihan read the Policy Statement as establishing two categories of advertising; the first comprised of clearly desirable programs such as conservation appeals and safety information and the second comprised of institutional, technical and community advertising. The Judge allowed RG&E $476,728 to cover all of the actual 1976 costs for the first category of advertising and then added to that amount $122,148, which represents 1/25

[1]As provided at page 14 *supra*, RG&E will be required to present evidence of expected 1978 labor productivity gains when it files for increased wages early next year.

of 1% of RG&E's revenues, the lower limit for *all* institutional and information advertising established in the Policy Statement.

Staff and the company except to Judge Moynihan's resolution of this issue. Staff correctly argues that the Judge has misread our guidelines. One part of the Policy Statement distinguished between allowed categories of advertising, informational versus promotional, and stated that desirable advertising such as conservation appeals and safety information as well as a reasonable amount for institutional advertising should be recoverable. That statement did not refer to the *level* of recoverable expenses in rate cases. For that purpose, we established the .0004 to .001 guideline limits to avoid the necessity in rate cases of reviewing advertising vouchers and specific advertisements to sort out the reasonable from the unreasonable. It is conceivable, for example, that RG&E's advertising costs were unreasonably high and that specific programs would have, upon scrutiny by staff, been deemed ineffective, redundant or just plain unnecessary. The Judge's decision to allow RG&E *all* of its test year expenses for informational advertising programs is, therefore, plainly inconsistent with the Policy Statement. The percentage limits were meant to apply to *all* informational and institutional advertising, as staff contends.

RG&E continues to argue for ratemaking recognition of the full amount of advertising expense that it incurred in 1976. It contends that the Policy Statement is unconstitutional and points to court decisions holding that managerial decisions are, in the absence of evidence to the contrary, presumed proper. RG&E fails to recognize, however, that it has the burden of proof in rate cases to establish that the expenses claimed are reasonable and representative of the level that will be incurred in the pertinent rate setting period. Except for a detailed

description of how it spent $755,982 for advertising in 1976, RG&E has made no effort to prove that this level of expenditure is reasonable and necessary and representative of a reasonable amount of advertising for the period for which rates are being established. It is not enough to say, in effect, "this is what we spent and this is how we spent it." The company has an obligation and a burden to demonstrate why those amounts are reasonable, particularly in light of the fact that the company's advertising costs are well in excess of the guidelines set in our Policy Statement. RG&E has failed to satisfy its burden of proof and, therefore, we reject the company's contention that it is entitled to recover in rates set here the full amount of advertising expense it incurred in 1976.

It remains to be answered where within our guideline limits RG&E's allowance for advertising expense should be set. Staff argues for the lower limit but there is nothing to suggest that this is a proper result. In view of the company's extensive conservation and safety advertising programs, we will allow the upper limit of the range set in our guidelines even though RG&E's size and compact territory would argue for an amount closer to the middle of the range. The company also claimed a 6% per year allowance to cover escalation in advertising expenses from 1976. No inflation factor will be applied because we have selected an amount which we find to be a reasonable level of advertising expenses for the ratemaking year 1978.

Escalation in Contractor Services

A 6% per year escalation factor has been added to those calendar 1976 expenses which were not the subject of a specific known change adjustment.[1] Staff concurred with all items in the

[1]We shall adjust the period of time to which this adjustment applies to more closely reflect the first year of new rates and to be consistent with our adoption of Judge Moynihan's resolution of the Ginna normalization issues.

expense base to which the escalation factor was applied save two: advertising expenses and contractor services. The escalation factor for advertising is discussed above. Staff removed contractor services from the inflation base because its analysis indicated that the amount expended for such services fluctuated from year to year, irrespective of the rate of inflation. RG&E's practice is to vary the amount of contractor and company labor to achieve optimum efficiency. Thus, the units of activity to be performed by contractors in 1978 may be higher or lower than the amounts so performed in 1976, a fluctuation which may serve to more than offset escalation in costs for contractor services. Judge Moynihan agreed with staff that it would be improper, for those reasons, to include contractor services in the inflation base. RG&E excepts.

The company argues that fluctuations in contractor services have represented substantial increases in all recent years but one. It further contends that 1976 units of activity performed by contractors has been deemed by staff to be a fair representation of the level expected in 1978. Staff, however, claimed that it was unable accurately to project future units of activity for contractor services and, therefore, would not endorse the 1976 level for use as part of an expense base for measuring future escalation. Staff observes that the 1976 units of activity have actually decreased from 1973-1974 levels and the 1974 level of expense for contractor services represents a high water mark which has not yet been surpassed.

In order for staff's theory to prevail, there would have to be some demonstration that the relationship of in-house labor to contractor services observed in the test period is not expected to be representative of the relationship in the period for which rates are being established. Uncertainty about the future distribution of units of activity is best resolved by treating the test period relationship as presumptively valid. This procedure is

reasonable since no adjustment to in-house labor costs is contemplated. Such costs would increase under an assumption that contractor services would decrease, assuming, of course, the same overall level of activity. We shall, therefore, include contractor services in the inflation base.

Charitable Contributions

Staff has relitigated the question whether charitable contributions should be recognized in expenses allowed for ratemaking purposes. Although we concluded in RG&E's last rate case that the advantages of continued recognition of utility charitable contributions outweigh the miniscule burden it imposed on ratepayers, staff has attempted to respond to the arguments made in that decision. Staff asserts that the principal question which must be decided is: who should make the decision about the contribution of an individual's income to a charity? Staff contends that permitting recovery of contributions through rates usurps the individual's right of choice and in fact levies a tax to support charities on persons who require electricity. It is contended by staff that the practice is something akin to the colonial Stamp Act, in that ratepayers are required to supply contributions but lack representation in the decision-making process as to which charities get corporate contributions.

Staff also maintains that a change in the Commission's policy will have very little impact on charities because the percentage of corporate contributions coming from utilities is quite small. Finally, staff responds to the Commission's observation that unregulated profit maximizing companies pass on charitable contribution costs to consumers in the price they set for their goods and services by the testimony of an economist who observed that a competitive firm's effort to achieve optimal output and price level is independent of its decision to use funds for charitable purposes.

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We have considered fully staff's renewed arguments on this issue but find no persuasive reason for modifying the policy expressed in RG&E's last rate case. We continue to believe that recognition for ratemaking purposes of a modest level of utility charitable contributions is warranted in light of the fact that such contributions are widely recognized as a legitimate and unavoidable cost of doing business.

Earnings Base in Excess of Capitalization

Consistent with Commission policy, an earnings base/capitalization test was performed in this case. Staff, finding that rate base exceeded capitalization, proposed to reduce electric rate base by $6.6 million and gas rate base by $1.1 million to bring the earnings base into balance with capitalization. Several issues have arisen as a result of Judge Moynihan's treatment of some of the components in the earnings base/capitalization test.

(a) *Use of Daily Balances*

Staff excepts to the Judge's adoption of a company proposal to employ monthly balances in calculating all of the components of the company's capitalization. Staff prefers to use daily balances for short-term and long-term debt because it contends that it will result in the most precise measure of total average capitalization. We confirmed the propriety of using daily balances for these items in RG&E's 1976 rate case. In that case, we recognized that use of daily average investment for all components would be the most accurate measure of capitalization but observed that an average daily balance could not be obtained for retained earnings. Accordingly, we authorized use of the combination of daily balances for short-term and long-term debt and average monthly balances for retained earnings as a proxy for the daily balances which were

impossible to obtain. Our decision in the company's last rate case is dispositive of this issue. Staff's exception was properly taken and will be allowed.

(b) *Canadea Power Corporation*

In the computation of RG&E's capitalization, the Administrative Law Judge included two accounts pertaining to its wholly owned subsidiary, Canadea Power Corporation. The accounts are Miscellaneous Paid in Capital and Undistributed Subsidiary Retained Earnings. The company argues, and the Judge agreed, that it had retained earnings from its subsidiary which represent an investment along with miscellaneous paid in capital. RG&E further pointed out that these two accounts were included in the computation of RG&E's capitalization in its last rate case.

Staff excepts to the inclusion of these accounts in deriving RG&E's capitalization for purposes of the earnings base/capitalization test. Staff maintains that inclusion of these accounts in capitalization is improper because the associated investment is not included in rate base. RG&E responds, however, that the short answer to this argument is that investment in associated companies should be included in rate base. But RG&E has not provided a basis for inclusion of the associated rate base items. The history of the Canadea Power Corporation transaction reveals that an original cost study of the Canadea assets has not been made. In these circumstances, we shall reverse the Judge's recommendation and exclude the Canadea accounts from capitalization for purposes of the earnings base/capitalization test to make rate base and capitalization consistent with respect to Canadea items, without prejudice to the company's right to litigate in its next rate case the issue whether the Canadea items should be included in rate base. To satisfy its burden of proof on this issue, RG&E needs a

validated original cost study to support inclusion of the Canadea item in rate base. We observe, however, that determinations of original cost incurred long ago often involve difficult judgment and time. The company, if it seeks inclusion of the item in rate base, should, therefore, settle this issue outside of a rate case.

(c) *Accumulated Deferred Income Taxes*

Judge Moynihan rejected staff's $1.5 million downward earnings base adjustment which would substitute the accumulated deferred income tax balance claimed by RG&E in rate base for the balance claimed in the earnings base. Staff asserts that its proposal is designed to make the two consistent. Because the computation of accumulated deferred income taxes in rate base was based on a two point average and the computation of retained earnings is based on a thirteen point average, RG&E claims staff's adjustment results in an unacceptable inconsistency.

Staff argues that retained earnings in the capitalization should be recomputed to eliminate this inconsistency; but it presses for acceptance of the principle that the rate base and earnings base computations should be consistent. RG&E responds that staff's suggested recalculation, which corrects for the discrepancy in averaging methodologies is not enough, in that it ignores the impact of the proformed matching of fuel expense and revenues on retained earnings.

We agree with staff that rate base and earnings base should be consistent and will adopt staff's adjustment. We also conclude that the company's position on retained earnings is wrong because our intention here is to determine the capital investment outstanding and entitled to a return and not to ascertain what retained earnings would look like if fuel were booked on a burn-up basis. Staff's averaging correction is all that need be done to achieve this result.

(d) *Dividends Declared*

Judge Moynihan adopted an adjustment proposed by the CPB to exclude the account "Dividends Declared" from the capitalization in making the earnings base/capitalization test. RG&E excepts to the exclusion, pointing out that this account refers to dividends declared but not yet paid. As such, the funds in the account are available to the company for use and are properly viewed as equity capital. We agree with RG&E that dividends payable are a proper component of capitalization. We shall, therefore, reverse Judge Moynihan's resolution of this issue.

Conversion Expenses

To complete its conversion from manufactured to natural gas, the company incurred expenses of $772,000 in the test year. Staff isolated $147,300 of this amount, the portion of the total that applied to contractor charges and associated materials and supplies, as nonrecurring in nature. For that reason, staff proposed an adjustment to delete this amount for ratemaking purposes. Judge Moynihan rejected staff's adjustment, finding that nonrecurring costs of this nature are necessary costs of business and that the amount was not large enough to warrant amortization. Therefore, he included the company's full test year cost of conversion in developing RG&E's revenue requirement.

Staff argues that it will not be necessary for the company to convert its mixed gas to natural gas during the first year of new rates and that the company has failed to show that it will have other expenses similar in nature during that period. RG&E responds that conversion expenses incurred during a prior year were recognized for ratemaking purposes in the company's last rate case. Staff also observes that the company's forecasts of gas expenses indicated decline from the 1976 level in the forecast period. RG&E points out that staff is willing to make selective

use of forecast information when it works to its advantage but considers the forecasts "worthless" when they work to the company's advantage.

We agree with Judge Moynihan's observation that costs of this nature are necessary expenses of doing business and, while the specific project averred to in this instance will not recur, that it is reasonable to assume that other nonrecurring expenses of similar magnitude are likely to be incurred in the period for which we are setting rates. We shall, however, amortize the $147,300 amount over a three-year period to reflect for ratemaking purposes an annual amount that should more closely approximate future conditions.

Amortization of Reserve Deficiency

There exists a considerable deficiency in the company's actual book gas depreciation reserve as compared to the theoretical reserve. The company asks to amortize the existing $4.6 million deficiency over a 20-year period at an annual rate of $230,000 per year and Judge Moynihan adopted the company's proposal. Staff claims that amortization of the deficiency is not necessary because the deficiency was artificially created when the company adopted service lives that were significantly lower than those indicated in mortality studies prepared in 1972 and the deficiency is currently decreasing at an acceptable rate. Staff argues that the deficiency was created when shorter than indicated lives were adopted and did not develop as a result of years of underaccruals. It contends that the deficiency will be eliminated in a reasonable period of time, without the need for an amortization. RG&E points out that the deficiency would require 30 years to eliminate assuming a $150,000 per year decrease due to current accruals. Staff responds that the rate of decrease is not constant but can be expected to increase with the addition of new plant. The company argues in response that

because substantial gas plant additions are quite unlikely in the near future, no acceleration in the natural reduction of the deficiency can be expected.

We are not persuaded that adequate progress is being made to reduce the book reserve deficiency nor do we see a reasonable prospect of substantial additions to gas plant that would work to hasten the reduction. Accordingly, we shall adopt the company's proposal and authorize the requested amortization.

RATE OF RETURN

The company's rate of return testimony was sponsored by W. Truslow Hyde, the same individual who testified for New York State Electric & Gas Corporation in its recent rate case and was the subject of a $10,000 rate case productivity adjustment proposed by staff who thought his testimony worthless.[1] Mr. Hyde employed the same methodology in this proceeding as he did in Case 26958, *The Brooklyn Union Gas Company.* His technique depends upon an observed relationship in the period 1957 through 1965 between bond yields and additional risk associated with equity securities. The validity of that relationship in current circumstances was questioned by the Commission in the *Brooklyn Union* case and more recently in *New York State,* and is equally suspect in this proceeding. In addition, the Consumer Protection Board introduced testimony of an expert witness who performed statistical tests of the risk factor relationship between bond yields and total returns sponsored by RG&E's witness and found the results of RG&E's methodology unreliable. In view of our rejection of RG&E's witness' methodology in previous cases, and the CPB's criticisms introduced into the record of this proceeding, we believe Judge

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[1]Cases 27103 and 27104 – *New York State Electric & Gas Corporation* (Opinion No. 77-16, issued October 17, 1977).

Moynihan was correct in relying instead on the rate of return presentations of staff and Genesee Valley People's Power Coalition as a point of departure for determining a proper return on equity for this company.

Staff computed a cost of common equity for RG&E at 12.8% on the basis of a discounted cash flow analysis and a study of cost spreads between common equity and long-term debt securities. Staff's DCF analysis combines an indicated 7.0% yield with a 5.4% growth rate which results in a capitalization or bare bones cost of equity of 12.4%. Staff adjusted this rate upward to 12.8% to reflect a market-to-book ratio of 1.06, to account for flotation pressures and underwriting spread. Staff's premium was supported by an analysis of common equity share expansion costs related to an October 1975 common equity issuance. That analysis measured pressure and spread at 5.7%.

Genesee's analysis resulted in a recommended return on equity of 12.2%, utilizing a DCF analysis which reviewed ten years of historical data for RG&E. Staff's analysis was largely based on a study of Moody's 24 Utilities and the 20 largest electric companies in the country. The major difference between staff's result and the result obtained by Genesee, however, results from Genesee's application of no premium for flotation pressure and underwriting costs. Judge Moynihan adopted the components of staff's DCF analysis but added a 15% premium because RG&E plans to issue substantial amounts of debt and stock in the near future. Application of a 15% premium raises the indicated cost of equity to 13.4%, which is the Judge's recommendation. Exceptions to his resolution of the rate of return issue have been filed by staff and the company.[1]

On exceptions, RG&E all but abandons the testimony of its rate of return witness and argues instead for modifications of

[1]Although Genesee sponsored testimony on this and other issues, its brief on exceptions, as we observed above, does not deal with specific substantive exceptions.

some of the numbers used in staff's DCF analysis which would yield a higher return on equity. The company first contends that an analysis of common stock yields from March 1976 through March 1977 indicates an average yield of 7.5%. Staff responds that this is, of course, true, but that the significance of the common stock yield data is that the indicated yield has been declining from March 1976 to the present time. The company's more current yield of about 6.8% serves to confirm the validity of a yield component no higher than the 7.0% used by staff.

RG&E next attacks the staff's selection, and the Judge's adoption, of a 5.4% growth rate component because it contends that the source data used in support of that percentage could readily have justified adoption of a higher rate. The company points to recent growth rates in earnings per share and dividends per share in support of this contention. Staff responds that the 5.4% growth rate is supported by a ten-year analysis of growth in book value (5.3%), a ten-year analysis of growth in dividends per share (5.0%) and an analysis of 1976 short-term growth in book value (5.0%). We find staff's reasoning more persuasive than the company's because RG&E appears to be selecting a rate for the growth component only because it will result in a higher return on equity, without a sound basis for the selection.

Staff's analysis suggested a capitalization rate of 12.0 to 12.4%, depending upon whether one utilized the 5.0% indicated by some of the growth data or the 5.4% suggested internal growth in book value. Staff's stated reason for selecting the upper end of this range was to take into account the company's large construction program and outside financing requirements. Staff, therefore, excepts to Judge Moynihan's selection of a higher premium for flotation pressure and underwriting spread than the one recommended by staff. The Judge selected a 15% premium basically for the same reason that staff picked the

upper end of the capitalization range. There is, therefore, a double counting in the Judge's result since staff had already taken the company's external financing requirements into account in the derivation of a capitalization rate.

The company, too, objects to Judge Moynihan's adoption of a market-to-book ratio (MBR) of 1.15 to allow for market pressure as well as flotation pressure and underwriting spreads instead of the 1.25 MBR target used by RG&E's witness. The company contends that the 1.15 MBR does not offer sufficient protection against market instability and that staff's recommended 1.06 MBR offers no such protection.

There appears to be no justification for use of an MBR as high as 1.25 as suggested by the company. Indeed, the company's witness effectively admitted that that premium was artificially high to provide some further insurance against the possibility that the allowed rate of return would not actually be earned. We conclude that market pressure associated with the company's external financing requirements has adequately been taken into account in the selection of a capitalization rate at the higher end of the indicated range, and find that staff's 1.06 MBR is adequate to cover flotation pressure and underwriting costs. As indicated above, that additional allowance can be expected to cover floation and underwriting costs on the basis of a study introduced by staff's witness.

In conclusion, we find that a 12.8% return on equity is proper in RG&E's present circumstances.[1] [2]

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[1] A return slightly below those we have recently authorized for other major combination gas and electric utilities is largely the result of RG&E's relatively high and less risky equity ratio of approximately 38%.

[2] The capital structure we adopt is set forth in Appendix C. We have substituted the actual fall 1977 debt financing for the projected figures reflected in the Judge's decision.

Appendix H

ELECTRIC RATES

Load Studies

Staff recommended that RG&E conduct a new load study of Service Classification No. 2 and that the results for low and high use customers be included in its load study for Service Classification No. 1. Judge Moynihan recommended that the company be ordered to prepare the load studies proposed by staff and RG&E excepts to this recommendation.

The company claims that its 1966 load study of S.C. No. 2 remains valid at this time because the frequency and average use per customer in that class have not changed significantly since the time the study was done. The company further contends that the results of S.C. No. 2 load studies would have very little impact on the outcome of a cost of service study. It concludes, therefore, that the additional expense required to perform new load studies in S.C. No. 2 is not warranted in view of the limited benefits that stand to be realized.

Staff responds that the most important piece of information to be gained from a load study in S.C. No. 2 is the kW of demand at particular points in time. It argues that there is no basis for believing that demands in S.C. No. 2 have remained static over time and feels the need for more up-to-date information. Staff was also critical of the fact that the company's 1966 study was based on an unstratified random sample. It proposes a stratified sample which would limit the sampling required for each group, cutting down on the cost of performing the study, yet producing more useful results. Staff has been unable to determine the size of the sample used in the company's 1966 study and, accordingly, questions its reliability and applicability.

With respect to load studies in S.C. No. 1, the company has no objection, in principle, to performing a load study of S.C. No. 1 high and low use customers and states that the results of such a study will be added to its S.C. No. 1 load study.

We find that staff has presented good and persuasive reasons for requiring RG&E to conduct, within two years of this date, a new load study in S.C. No. 2 and to perform the study of S.C. No. 1 high and low use customers. Although the company objects to the required incurrence of additional costs for the requisite meters, the dollars will be well spent since rates more closely tied to costs will be developed.

Allocation of PASNY Power and Cost Studies

In the company's last rate case, we observed that a cost study introduced by RG&E erroneously assigned the benefits of low cost PASNY power to the system as a whole instead of to the residential service class. Staff asks in this case that RG&E be directed, in future cost studies, to assign PASNY firm capacity and associated energy to the residential class.

Judge Moynihan observed that if staff disagrees with the methodology proposed by the company in future cost studies it is free to develop its own study assigning PASNY power in the fashion which it believes proper. Staff, in its brief on exceptions, asks us to state clearly that its methodology constitutes the proper treatment of PASNY power in cost studies. RG&E responds that the proper treatment of PASNY power for these purposes was not adequately explored in the record and that a determination on this issue should be deferred to a future proceeding.

Contrary to RG&E's contention, we do not believe that this issue is unresolved. In future cost studies, RG&E should allocate PASNY power to the residential class instead of to the system as a whole.

Appendix H

Old House BeeBee

Steam production at the so-called Old House BeeBee station is used by both the Steam and Electric Departments; but the steam transfer credit is computed solely on the basis of production costs. No fixed costs of the Old House BeeBee station are allocated to the Steam Department. Staff argues that future circumstances may warrant an allocation of fixed plant investment costs associated with the BeeBee station to the Steam Department. Accordingly, it asks that we direct RG&E to submit, in its next rate case, justification for the electric system's continued need for the Old House BeeBee capacity, which is the basis for allocating all of the fixed costs associated with that station to that Department. Also, staff would have the company analyze the financial impact on the Steam Department that would result if the steam transfer credit were adjusted to include an allocation of fixed costs of Old House BeeBee.

The uncertainty of proper allocation raised by staff for pricing purposes affects, as well, decisions on the proper classification of plant by line of business. Thus, it seems clear that a study along the lines suggested by staff should be conducted by RG&E not only for the reason requested by staff, but also to determine the proper classification of this plant for accounting purposes. We shall require that RG&E make and present to us within six months the study requested by staff in order to justify its present accounting practices.

Fuel Adjustment Clause Factor of Adjustment

The company points out that Judge Moynihan's decision failed to reflect an unopposed adjustment which it introduced that would apply the most recent factor of adjustment to the company's fuel adjustment clause. We will include here a $220,348 reduction to fuel clause adjustment revenues to reflect the latest available factor of adjustment.

Appendix H

GAS RATES

Interdepartmental Gas Charges

The Administrative Law Judge adopted staff's proposal to proform interdepartmental gas charges so that gas used for or by the Electric and Steam Departments is billed on a monthly basis. Staff originally contended that its method, which would simply compute the interdepartmental charge on the basis of each month's usage priced at December 31, 1976 rates, would be consistent with the manner in which the company books its interdepartmental charges.

RG&E, on the other hand, contends that staff's proposal is not consistent with its booking procedure because the staff approach would not use an annualized monthly cost of gas. According to the company, it uses a procedure for purposes of both gas adjustment clause and for interdepartmental charges, of determining an average cost of gas for a 12-month period ending two months earlier and using that cost as a basis for both the GAC and for pricing interdepartmental sales. From another view, the company applies current supplier rates each month to its actual purchased gas volumes over a rolling 12-month period. The company points out that this procedure is used to smooth out fluctuations that would be extant if a monthly unannualized cost of gas was used.

RG&E also observes that the pro forma adjustment offered by staff and adopted by Judge Moynihan would be inconsistent with the method of charging electric and steam interdepartmental sales.

Staff has not responded to the company's exception and had indicated earlier, on brief to the Judge, its agreement with the company. The company's exception is well taken and will be allowed.

Appendix H

Transfer Price

In order to reflect more nearly the value of gas to the Electric and Steam Departments, staff proposed to price the gas so used at either the equivalent cost of alternate fuel or the lowest firm block rate. The current transfer price is equivalent to the average cost of gas, including losses. Staff argues that, under the existing arrangement, there is no benefit to the gas consumer from interdepartmental sales, whereas the Electric and Steam Departments and their consumers receive the benefit of a low cost energy source. The effect of staff's adjustment would be to increase charges to the Steam Department by $198,000 and to the Electric Department by $20,200. Under staff's proposal, these increased charges would flow through to gas consumers by operation of the gas adjustment clause. Judge Moynihan declined to accept staff's proposal because much of the gas consumed by the other departments is off-peak and because RG&E's Electric and Steam Departments pay the reimbursement to dual-fuel customers on an equal footing with other gas customers.

The company objects to staff's proposal to introduce value pricing on an interdepartmental basis because it would apply only to gas service whereas interdepartmental charges for electricity and steam used by the Gas Department would remain priced on average cost basis. RG&E also points out that staff's proposal singles out its other departments from all other gas customers and would apply value based pricing only on an interdepartmental basis.

We agree with staff that the transfer price of gas should be adjusted to reflect more closely the benefits of gas to the electric and steam departments. We do not, however, agree with staff that all of the electric and steam departments' usage should be priced at the same level. The transfer price for gas used for boiler fuel has been an issue in numerous rate proceedings, most

notably Case 26589, *Electric Space Heating*, 15 NY PSC 115 (1975), which established a transfer price for downstate utilities at the cost of gas plus 24 cents. Although that level has been subsequently increased in rate proceedings, we will set the price here at the cost of gas plus 24 cents as a starting point, subject to modification in conjunction with future rate proceedings. Ignition requirements should be priced at the lowest firm customer end block rate.

STREET LIGHTING

The City of Rochester (the City) objects to the allocation of the revenue increase to street lighting customers on the grounds that RG&E's failure to comply with the notice requirements of Section 202 of the State Administrative Procedure Act (SAPA) bars consideration of any street lighting tariff rates in this proceeding.

At the present time, RG&E renders street lighting service under individual customer contracts. On December 3, 1976, RG&E filed with the Commission new schedules for gas and electric service to become effective January 3, 1977. The notice of hearing for this general rate proceeding, Cases 27108 and 27109, dated December 10, 1976 and published in the State Bulletin on December 21, 1976, contained the following statement:

> "The Commission may approve, modify or reject any or all of the proposed tariff changes. Among other things the Commission may require revisions of the proposed amount of increase applicable to particular types of service or changes in the rates applicable to those types of service for which no increase has been proposed by the company."

On January 21, 1977, RG&E filed with the Commission a new tariff for electric street lighting service to replace the contracts for service. This tariff was to become effective on March 15, 1977.

Notice of this petition was published in the State Bulletin on February 1, 1977. A month later, on March 1, 1977, we granted a request by the City for a hearing on the street lighting tariff proposal. Although not requested by the City, we chose to use the then ongoing hearings in Case 27108 (RG&E's application for an electric rate increase) as the procedural vehicle for the City's hearing request and directed that the street lighting hearing be joined with Case 27108.

The City argues that it received inadequate notice under SAPA Section 202 and, therefore, the proceedings, and any determinations made in them, are invalid with regard to street lighting. It asserts that the first notice of publication made in December for the general rate case, Case 27108, was not relevant to the street lighting service because it was published almost a month before RG&E had even proposed that street lighting tariffs replace existing contracts. The City argues, and we agree, that, as a contract purchaser for street lighting service, it could not be held to have received notice of hearings relevant to their street lighting rates as a result of the December notice.

The City also contends that notice published by RG&E on February 1, 1977 regarding a proposed new street lighting tariff was inadequate under SAPA Section 202.2. We have carefully considered the City's arguments as to the February notice and conclude they lack merit for the following reasons:

(a) The City objects on the grounds that the notice made no mention of a hearing to be held on the street lighting issue. The City acknowledges that a hearing would not be required (Public Service Law Section 66(12)) for this matter. The notice clearly stated that "the Commission may adopt, reject or modify the proposal with or without public hearings."

(b) The City objects that no specific hearing date was given in the notice. SAPA Section 202.2(b)(2) requires that the notice

". . . give the time and place of any public hearing *or* state the manner in which data, views or arguments may be submitted to the PSC." The February 1, 1977 notice did provide information on submission of "data, views or arguments" to the Commission.

(c) The City contends that the notice failed to clearly state the "subjects and issues" involved. The notice states that RG&E "proposes to commence serving street lighting under a new tariff." No clearer statement of subject and issues could be expected. The notice further indicated where full details of the proposed tariff could be obtained. Therefore, the City's objection that the notice published in the State Bulletin on February 1, 1977 was defective on this ground is not sustainable.

(3) The City argues that joinder of the street lighting hearing with the ongoing general rate hearing, Case 27108, "embroiled it within a separate PSC case, involving rate increases, pursuant to a hearing order notice never published as required by SAPA, with the next hearing only days away." The City asserts that its rights were prejudiced by the inadequate amount of time it had to prepare its case. However, hearings in this proceeding continued for more than three months after joinder of the street lighting issue to the main proceeding. Furthermore, the City must have been aware that its request for a hearing on the proposed street lighting tariff, submitted while hearings were being held relative to a proposed general rate increase, could reasonably have lead to a consolidation of the hearings.

The City does not allege that it did not know of the hearings in which the street lighting issue was actually discussed. Nor does it mention the fact that the Commission decided to join the street lighting tariff with the general rate case one month after notice of RG&E's proposal for a new street lighting tariff had been made. If RG&E's notice had specified a hearing date of March 1, 1977, the date the Commission ordered the issues joined, the notice would have been timely served. The City's

objection is then reduced to an absurdity—where hearings are not required, is notice of a proposed change defective when, after 30 days has been allowed for submission of argument, the Commission decides hearings shall be held through utilization of a well-publicized and extensive ongoing proceeding? If we had decided to deny the City's request for a hearing and on March 1 adopted RG&E's proposal, there would be no cause for objection. Our decision to hold a hearing on the matter cannot reasonably be viewed as valid grounds for objecting to the adequacy of the published notice.

(4) The City also makes much of an RG&E letter, sent on January 20, 1977 to its street lighting customers, which stated that the proposed tariffs would not affect current customers' rates. Apparently the City urges that we adopt an "estoppel theory" to prevent RG&E from increasing rates in the new tariff. Such an argument overlooks the recommendation of the Administrative Law Judge that the new tariff become effective for each customer only when its existing street lighting contract expires.

We conclude that the February notice fully met the requirements of SAPA and deny the City's exception.

CONCLUSION

Our resolution of the issues raised in this case indicates that Rochester Gas and Electric Corporation requires additional annual electric revenues of $10,186,000 and additional annual gas revenues of $2,536,000, as set forth in Appendix A.

The Commission orders:

1. Rochester Gas and Electric Corporation is directed to cancel the revised tariff leaves and supplements listed in Appendix B on or before November 2, 1977.

2. Rochester Gas and Electric Corporation is authorized to file such amendments to its electric and gas tariff schedules that will produce revenue increases in an amount and manner consistent with the findings and conclusions in the foregoing decision. The company shall serve copies of its compliance filing on all parties listing appearances in this proceeding. Comments must be received at the Commission's offices within three (3) days of service of the company's proposed amendments, if personally served, and within five (5) days if served by mail. The amendments shall not take effect until approved by the Commission.

3. Rochester Gas and Electric Corporation is directed to undertake the studies referred to in this Opinion and Order in the manner set forth in the text of this decision.

4. Except as here granted, all exceptions to the Administrative Law Judge's recommended decision are denied.

5. Except as here modified, the findings and conclusions of the Administrative Law Judge's recommended decision are adopted as part of this Order.

6. This proceeding is continued.

By the Commission,

(SEAL) (SIGNED) SAMUEL R. MADISON
Secretary

Appendix H

Cases 27108
27109

APPENDIX A
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ROCHESTER GAS AND ELECTRIC CORPORATION
REVENUE REQUIREMENT
ELECTRIC

1.	Rate Base per Commission	$421,786,965
2.	Recommended Rate of Return	9.31%[1]
3.	Return Required	$ 39,268,366
4.	Operating Income per Commission	$ 34,257,009
5.	Additional Return Required	$ 5,011,357
6.	Additional Revenue Required before F.I.T. (Line 5 + .52)	$ 9,637,225
7.	Gross Revenue Required (Line 6 + .94607)[2]	$ 10,186,588

[1]The following capital structure for rate of return and imputed interest was used. (Prime rate of 7.5% substituted for 7.0% to reflect more current rate.)

	Ratio	Rate	Return
Long Term Debt	48.6%	7.22	3.51
Customer Deposits	.1	8.00	.01
Preferred Stock	13.4	7.04	.94
Common Equity	37.9	12.80	4.85
	100.0		9.31%

[2]Advertising	.1%
Injuries and Damages	.5
Uncollectibles	.619
Gross Revenue Taxes	4.174
	5.393%

Appendix H

Cases 27108
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APPENDIX A
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ROCHESTER GAS AND ELECTRIC CORPORATION
COMMISSION ADJUSTMENTS TO OPERATING INCOME
ELECTRIC

Adjusted Operating Income per ALJ		**$34,169,776**
Commission Adjustments to Net Operating Income		
1. Advertising		278,718
2. Escalation		
a. Pro-Rata Portion	140,595	
b. Advertising	29,144	
c. Contractor Services	(491,347)	
		(321,608)
3. Interdepartmental Charges		2,442
4. Revised Factor of Adjustment		(220,343)
5. Post-Record Adjustments–		
Per Company	454,857	
Less: Staff Adjustment	16,059	
		(438,798)
Total Commission Adjustments to Operating Income before F.I.T.		(699,589)
Adjustments to Federal Income Tax		
6. F.I.T. Effect of Adjustments 1-5 Above (699,589 × 48)		335,803
7. Interperiod Tax Allocation		371,040
8. F.I.T. Effect due to Change in Capital Structure and Prime Interest Rate[1]		96,368
9. F.I.T. Effect on Commission Adjustments to Rate Base[2]		(16,389)
Adjusted Operating Income per Commission		$34,257,009

[1]See footnote 1 on page 1 of this Appendix.

[2]Excluding excess earnings base and non-revenue producing plant (adjustments 2 and 3, page 3 of this Appendix.

Appendix H

Cases 27108
27109

APPENDIX A
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ROCHESTER GAS AND ELECTRIC CORPORATION
COMMISSION ADJUSTMENTS TO RATE BASE
ELECTRIC

Adjusted Operating Income per ALJ		$403,712,367
Commission Adjustments to Rate Base		
1. Coal Inventory		(964,936)
2. Non-Revenue Producing Plant		21,601,000
3. **Excess Earnings Base**		
a. Daily Balance	(1,659,510)	
b. Equity in Subsidiary	(1,473,336)	
c. Accumulated Deferred Income Taxes	(1,265,265)	
d. Dividends Payable	1,841,701	
		(2,556,410)
4. Working Capital Effect of Commission Adjustments to O&M (1/8 × 40448)		(5,056)
Adjusted Rate Base per Commission		$421,786,965

Appendix H

Case 27109

APPENDIX A
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ROCHESTER GAS AND ELECTRIC CORPORATION
RECOMMENDED REVENUE REQUIREMENT
GAS

1.	Rate Base per Commission	$126,093,001
2.	Recommended Rate of Return	9.31%
3.	Return Required	$ 11,739,258
4.	Operating Income per Commission	$ 10,492,306
5.	Additional Return Required	$ 1,246,952
6.	Additional Revenue Required before F.I.T. (Line 5 ÷ .52)	$ 2,397,985
7.	Gross Revenue Required (Line 6 ÷ .94571)[1]	$ 2,535,645

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[1]Advertising	.1%
Injuries and Damages	.5
Uncollectibles	.669
Gross Revenue Taxes	4.160
	5.429%

Appendix H

Case 27109

APPENDIX A
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ROCHESTER GAS AND ELECTRIC CORPORATION
COMMISSION ADJUSTMENTS TO OPERATING INCOME
GAS

Adjusted Operating Income per ALJ		$10,242,302
Commission Adjustments to Net Operating Income		
1. Advertising		37,780
2. Escalation		
a. Pro-Rata Portion	45,710	
b. Advertising	12,813	
		58,523
3. Interdepartmental Charges		(38,254)
4. Contractor Services		98,200
5. Purchased Gas Curtailment		327,390
6. Post-Record Adjustments—		
Per Company	78,181	
Less: Staff Adjustment	28,351	
		(49,830)
Total Commission Adjustments to Operating Income before F.I.T.		433,809
7. F.I.T. Effect of Adjustments 1-6 Above		(208,228)
8. F.I.T. Effect due to Change in Capital Structure and Prime Interest Rate[1]		24,753
9. F.I.T. Effect on Commission Adjustments to Rate Base		(330)
Adjusted Operating Income per Commission		$10,492,306

[1]See footnote 1 on page 1 of this Appendix.

Appendix H

Case 27109

APPENDIX A
Page 6 of 6

ROCHESTER GAS AND ELECTRIC CORPORATION
COMMISSION ADJUSTMENTS TO RATE BASE
GAS

Adjusted Rate Base per ALJ		$126,164,597
Commission Adjustments to Rate Base		
1. Excess Earnings Base		
a. Daily Balance	(428,468)	
b. Equity in Subsidiary	(380,400)	
c. Accumulated Deferred Income Taxes	475,507	
d. Dividends Payable	281,296	
		(52,065)
2. Working Capital Effect of Commission Adjustments to O&M (1/8 + 156249)		(19,531)
Adjusted Rate Base per Commission		$126,093,001

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CASES 27108
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APPENDIX B

ROCHESTER GAS AND ELECTRIC CORPORATION TARIFF LEAVES

Electric

Amendments to Schedule PSC No. 9

Fourth Revised Leaves Nos. 46 and 47
Tenth Revised Leaves Nos. 31, 33, 35, 38, 44 and 45
Eleventh Revised Leaf No. 43
Supplement 16 and Supplement 17

Gas

Amendments to Schedule PSC No. 10

First Revised Leaves Nos. 40, 41 & 42
Supplement No. 1
Supplement No. 5

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APPENDIX C

ROCHESTER GAS AND ELECTRIC CORPORATION
Estimated Cost of Capital
Average, Year ending December 31, 1978

	(000) Amount	Percent	Cost Rate	Return Element
Long Term Debt*	$378,743	48.6	7.22	3.51%
Customer Deposits	455	.1	8.00	.01%
Preferred Stock**	104,450	13.4	7.04	.94%
Common Equity***	295,678	37.9	12.80	4.85%
Total	$779,326	100.0		9.31%

*Reflects the actual $50 million of debt issued on 9/22/77 at a cost of 8.45% and one half a $40 million issuance planned during 1978 at a cost of 9.0%.

**Reflects one half a 1978 issuance of $25.0 million at a cost of 9.25%.

***Reflects sale of $21 million of common equity on 9/21/77, as well as retained earnings over the period.

Appendix I
Recommended Decision of the Administrative Law Judge of the Public Service Commission of the State of New York, August 5, 1977

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 27108 – Proceeding on motion of the Commission as to the rates, charges, rules and regulations of the Rochester Gas and Electric Corporation for electric service.

CASE 27109 – Proceeding on motion of the Commission as to the rates, charges, rules and regulations of the Rochester Gas and Electric Corporation for gas service.

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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 27108 – Proceeding on motion of the Commission as to the rates, charges, rules and regulations of the Rochester Gas and Electric Corporation for electric service.

CASE 27109 – Proceeding on motion of the Commission as to the rates, charges, rules and regulations of the Rochester Gas and Electric Corporation for gas service.

APPEARANCES:

Appearances are listed in Appendix A.

WALTER T. MOYNIHAN, Administrative Law Judge:

On December 3, 1976, Rochester Gas and Electric Corporation (RG&E or the company) filed with the Commission new schedules for electric and gas service to become effective January 3, 1977. The schedules were designed to increase revenues by $20,095,900 or 12.2% in the electric operations and $6,997,500 or 7.3% in the gas operations based upon estimated sales data for 1976. The proposed rates were suspended by the Commission through November 2, 1977.

In addition, on January 21, 1977, the company filed with the Commission a new schedule for electric street lighting service to become effective March 15, 1977. At the present time, RG&E renders street lighting service under individual contracts. The Commission suspended the street lighting proposal through January 12, 1978, and broadened Case 27108 to include the propriety of the company's proposed street lighting tariff. Since further hearings are scheduled for the street lighting proposals, a separate report will be presented on that subject.

Appendix I

Public hearings were conducted in Rochester on 12 days from January 18, 1977 through June 29, 1977. In addition, joint hearings were held with Case 26806 - Proceeding on motion of the Commission as to rate design for electric corporations, on January 25 and 26, 1977 in Albany. Participants at the hearings included RG&E, the Staff of the Public Service Commission (Staff), the Consumer Protection Board (CPB), the Genesee Valley Peoples Power Coalition (Genesee), and the City of Rochester (Rochester or the City). Collectively they presented 33 witnesses.

The table on the following page sets forth the adjusted operating incomes and rate bases proffered by RG&E for the year 1976 under present rates. These figures include many of Staff's adjustments, which the company accepted. Also listed are the disputed adjustments proposed by Staff and the results of the recommendations in this report.

Normalization of Ginna Station Operations

Ginna, a nuclear generation station, had a rated capacity of 470,000 kW during most of 1976. However, its capacity factor was 50%, which is less than the planned capacity factor of 75%. The lower capacity factor was attributed to repeated failures of a turbine blade. Since there were a number of blade failures in Ginna and other similarly designed plants, the rotor was removed and baffles were installed in its place. Thus, the rated capacity of the station was reduced to 400,000 kW in the latter part of the test year.

Appendix I

CASES 27108 and 27109

RG&E's ADJUSTED OPERATING INCOME, RATE BASE AND RATE OF RETURN UNDER PRESENT RATES

For 12 months ended December 31, 1976

Item	ELECTRIC DIVISION		GAS DIVISION	
	Per Staff	Recommended	Per Staff	Recommended
Adjusted operating income per company	$33,051,366	$33,051,366	$10,180,185	$10,180,185
Additional adjustments:				
1 Normalize Ginna operations	1,607,012	1,133,687		
2 Purchased gas curtailment			397,043	69,653
3 Adjust interdepartmental charges	(2,442)	(2,442)	38,254	38,254
4 Eliminate contributions	284,750		74,299	
5 Reduce advertising expenses	540,136	146,887	116,593	10,219
6 Eliminate contractor expenses			147,300	
7 Amortize depreciation reserve deficiency			230,000	
8 Additional productivity improvements	208,000	208,000		
9 Reduce escalation allowance	594,652	562,859	29,279	6,667
10 Federal income tax on above items	(1,551,412)	(983,516)[a]	(495,729)	(59,901)[a]
11 Ginna flow through tax depreciation	60,309	50,258		
12 Ginna deferred f.i.t.	(19,488)	(16,240)		
13 Ginna flow through investment tax credit	70,000			
14 Interperiod tax allocation	371,040			
15 Interest deduction on post test year additions	1,510	18,917[a]	8,424	(2,775)[a]
Adjusted operating income	$35,215,433	$34,169,776	$10,725,648	$10,242,302
Adjusted rate base per company	$406,604,160	$406,604,160	$127,220,190	$127,220,190
Additional adjustments:				
16 Normalize Ginna	1,831,831	1,300,560		
17 Accumulated deferred f.i.t. – Ginna	(19,488)	(16,240)		
18 Investment tax credit capitalized – Ginna	(210,000)			
19 Amortization of reserve deficiency			115,000	
20 Working capital –1/8 of O&M	(195,840)	(114,413)[a]	(51,613)	(6,893)[a]
21 Coal inventory	(1,254,579)			
22 Excess earnings base adjustment	(6,618,110)	(4,061,700)	(1,100,765)	(1,048,700)
Adjusted rate base	$400,137,974	$403,712,367	$126,182,812	$126,164,597
Indicated rate of return	8.80%	8.46%	8.50%	8.12%

[a]Recomputed to conform with other recommended adjustments.

Appendix I

Although RG&E expects to purchase a new rotor for $3.5 million on June 1, 1978, which would restore the capacity rating of Ginna to 470,000 kW, the company adjusted the test year to reflect operations at 400,000 kW and 75% capacity factor. Thus, contract sales, incidental sales, fuel costs, pool purchases and the mix of generation were adjusted.

On the other hand, Staff looked forward to the first calendar year that the new rates would be in effect, and normalized the operations of Ginna by reflecting operations at 75% capacity factor and at the 400,000 kW level through June 1, 1978 and 470,000 kW for the remainder of the year. After adjusting to include the excess energy as incidental pool sales, operating income before federal income taxes was increased by $1,607,012 (Item 1); and net plant was increased by $1,831,831 (Item 16) to reflect the inclusion of the new rotor. In addition, tax depreciation was flowed through to the customers in the amount of $60,309 (Item 11), deferred federal income tax was increased by $19,488 which resulted from ADR tax deferrals (Item 12) and the rate base was offset by the accumulated deferred federal income taxes of $19,488 (Item 17). Also, since the installation of the new rotor generates an investment tax credit (ITC), Staff adjusted operating income by $70,000 (Item 13) and capitalized ITC in the amount of $210,000 (Item 18). Both of the ITC adjustments conform with Commission guidelines for the treatment of ITC.

According to Staff, if the new rotor for Ginna cannot be installed by June 1, 1978, the company upon receipt of such knowledge should notify the Commission so that the electric rates may be adjusted. Since the Staff suggestion, to consider corrective rate treatment if the rotor is not installed on time, would only cover events known before the Commission renders its decision, RG&E maintains that Staff's suggestion is of little solace to the company for a delay which becomes known after the

Commission decision, unless it provides for a retroactive, automatic adjustment.

RG&E argues that the restoration of Ginna to 470,000 kW is not a known change because the rotor may not be manufactured, installed and properly operating by June 1, 1978 and therefore Staff's adjustment should not be accepted.

Assuming Staff is correct and Ginna is restored to 470,000 kW on June 1, 1978, RG&E contends that the sale of all the additional power is unlikely because nuclear generation is used first to displace higher cost power for sales to retail customers; and the displaced fossil fuel generation is available for sale to other utilities. Moreover, the additional generation might well be available at times when neither resale nor retail customers would have a need for it. Finally, even if Ginna is fully restored on June 1, 1978, RG&E noted that, during the first year the new rates would be in effect, Ginna would be rated at 400,000 kW for about seven months and not the five months used by Staff.

Although installation of the new rotor would generate the investment tax credit imputed by Staff, the company maintains that it will not be permitted to utilize the credit even with the full rate relief requested since its carry-forwards and generated investment tax credits exceed the maximum allowance RG&E can utilize.

Genesee noted that, before Ginna went on line in 1970, RG&E had adequate capacity to meet its peak, and that the Commission allowed an 80% addition to the system capacity, all of which was excessive, and marketable only at wholesale prices subsidized by retail customers. According to Genesee, the stockholders, rather than the customers, should suffer the loss.

Genesee proposed that Ginna's operations be normalized to 80% of the name plate capacity by substituting nuclear power for fossil generation which would decrease expenses by

$10,220,685. As alternatives, Genesee would remove that part of Ginna not serving retail customers (76.7%) from the rate base or it would reduce the return on equity to the current bond return of 8.5%.

The theory behind Staff normalization of Ginna is proper, that is, the electric rates should reflect the operating conditions expected to exist during the first year the proposed rates will be in effect. Since the company estimated that the rotor would be installed by June 1, 1978, Staff's imputation of additional generating capacity is reasonable.

RG&E's claim that it cannot sell the excess power produced by the new rotor in essence would place the financial burden of carrying the cost of Ginna upon the ratepayers. Thus, if additional sales are not imputed in this case and as time goes on RG&E sells the power, the stockholders will receive a windfall profit. Genesee's position is in direct opposition, that is, the stockholders should bear the risk of the entire Ginna plant. On the other hand, Staff divides the cost of the rotor and plant between ratepayer and stockholder by assuming that additional power would be sold as incidental pool sales, which are generally priced at the midpoint between the marginal pool price of the buyer and the cost of the seller. Staff's adjustments, as modified below, should be accepted.

Inasmuch as Staff employed the year 1978 in computing its adjustment instead of the first full year of new rates, 12 months ending November 2, 1978, Staff included about two months extra capacity at 470,000 kW. The adjustment will be modified to reflect operation during the first full year of new rates; thus Item 1 is $1,133,687 and Item 16 is $1,300,560.

Federal income taxes need to be adjusted to ten-twelfths (tax depreciation is permitted in full for all additions prior to June 30 of the year); therefore, Item 11 should be $50,258, Item 12 should

be ($16,240) and Item 17 should be ($16,240), respectively. Staff's investment tax credits, Items 13 and 18, should not be accepted inasmuch as the company cannot utilize the credits in the first full year of the new rates.

Purchased Gas Curtailment

In early 1977, RG&E curtailed supplies in the amount of 570,317 Mcf to Category I dual-fuel customers and to customers who exceeded their volumetric limitations. These customers have not been reconnected to the system. The company normalized its test year gas operations to reflect the decline in sales which decreased operating income before federal income taxes by $397,043. It was noted that this adjustment does not fully reflect the current natural gas curtailment. For example, additional customers were curtailed for an annual revenue loss of about $3.0 million and new services are not being attached, which will lead to attrition in customers. RG&E asks that the 570,317 Mcf purchased gas curtailment be considered a reasonable surrogate for the revenue impact of its expected sales reductions.

Staff maintains that it cannot determine if the curtailments will continue into the first year of new rates, since RG&E should have a sufficient supply of gas to serve its customers in 1978 as adjusted for normal weather. Thus, Staff assumes the customers will be reconnected and reverses the $397,043 purchased gas curtailment adjustment (Item 2).

The purchased gas curtailment adjustment was derived on the basis of actual curtailments to specific groups of customers. Inasmuch as no relationship was shown to exist between these curtailed supplies and RG&E's claimed reduction in sales to all customers, the purchased gas curtailment adjustment should not be accepted as a surrogate for some other adjustment. Rather, the adjustment should stand or fall on its own.

The existing customers should bear the full cost of supplying the gas because the gas service was curtailed for their benefit. If, in the future, RG&E seeks permission to reconnect the curtailed customers, it should also submit a plan to prevent windfall profits. RG&E's adjustment should be accepted but modified to include only the base rate revenue and the base cost of gas. This eliminates any mismatch between revenues and expenses. The operating income before federal income taxes will be increased by $69,653 which is the net effect of the gas adjustment clause revenues, associated purchased gas expense and revenue taxes.

Interdepartmental Charges

RG&E's electric, gas and steam operating divisions service and charge each other on a monthly basis. During the test year the gas division supplied to the electric division about 130,000 Mcf, of which 24,700 Mcf or 19% was used for generation of electricity and 105,300 Mcf or 81% was consumed for purposes other than generation. The exhibits in these cases show that the company's gas division computed the price of the gas sold to the electric department on an annual basis. More specifically, the 12 months of consumption was priced at the December 31, 1976 cost of gas. The electric and steam interdepartmental charges were likewise computed.

Staff objects to the company's method of computing the cost of gas billed the electric and steam divisions for rate case purposes. According to Staff, the charge should be the sum of each month's usage priced at the December 31, 1976 rates. In other words, Staff would bill monthly rather than annually as claimed by RG&E.

Staff noticed that its method is consistent with the way consumption is actually charged on the company's books. Staff increased the gas division's operating income before income taxes by $38,254 and decreased the electric division's by $2,442

(Item 3) to reflect the monthly billing of gas. Since the gas department's cost of electricity and steam is about one-seventh of the gas bills rendered to other departments, Staff did not compute the cost of electricity and steam on a monthly basis.

First, although RG&E books its interdepartmental charges monthly, he company noted that the actual charge is not based on a single month's average gas cost. Thus, Staff's adjustment is not exactly the company's method of recording interdepartmental charges on its books. Second, since Staff only adjusted the gas department charges, it does not match the methodology of the other departments; a consistent approach, according to RG&E, may result in a wash of the adjustment.

Of course, consistency requires that the same method of billing be applied to each department; nevertheless, in view of the relatively small charges by the other departments, they may be ignored. For purposes of proforming the interdepartmental charges, i.e., those likely to pertain when the rates set in this proceeding are in effect, Staff's adjustment should be accepted because the gas charges are booked monthly.

Transfer Price of Gas

Staff proposed that the price of gas used for electric generation be set equal to either the price of alternate fuel for similar uses, or the last block of SC No. 1 - Residential, whichever is greater, and that the revenues from these sales, less the cost of gas, should be flowed through the gas adjustment clause. In the case of gas used by the steam department, the alternate fuel would be coal; for the electric department, it would be the appropriate fuel oil.

If Staff's adjustment were in effect during the test year, the steam department would have paid an additional $198,000 at the current gas rates and the electric department would have paid

an additional $20,204 based upon the cost of fuel oil at $2.28 per million BTU. Under Staff's proposal, all these monies would have been passed back to gas consumers through the gas adjustment clause. As long as the pass-back mechanism is combined with the increase in price, no adjustment to operating income is necessary.

Staff argued that the current transfer price does not fully reflect the value of the gas used by the other departments. For example, RG&E's tariff currently contains a "pay-back" provision, whereby some dual-fuel customers, in the event of curtailment, are reimbursed for the difference between the cost of gas and the cost of their alternate fuel. The money for this reimbursement is obtained from all the company's gas customers through the gas adjustment clause. The company is, in effect, buying the gas from these dual-fuel customers at the price of their alternate fuels in order to provide uninterrupted service to higher priority customers. These higher priority customers include the electric and steam departments. According to Staff, it is improper to continue to offer high priority gas to these departments at lower rates than those paid by certain low priority firm customers.

RG&E pointed out that it cut back the use of gas for steam production six days before it required other customers to curtail their usage during last year's gas crisis. If the steam department had not been curtailed first, RG&E observed that the steam department would pay its share of the reimbursement to dual-fuel customers. In addition, the company objects to Staff's charging the steam and electric department rates based on value of service while charging the remaining 207,000 gas customers on a cost basis because the value priced interdepartment charges would reduce the cost of gas to tariff customers still further below the value of gas.

Appendix I

Since RG&E's electric and steam departments pay the reimbursement to dual-fuel customers on an equal footing with other gas customers and because they consume much of the gas off-peak, Staff's proposal is not accepted.

Charitable Contributions

Staff proposed reductions in the test year expenses of $284,750 in the electric division and $74,299 in the gas division (Item 4) to remove the cost of charitable contributions. These costs are slightly more than six cents per customer per month.

Since RG&E is a monopoly with a market franchise and prices set on a cost-plus basis, Staff and the CPB maintain that the company should provide electricity at the lowest cost possible and not decide which charities should be subsidized by the ratepayers. According to Staff, private industries' contributions to charities decrease profit since their prices are set on a competitive basis. Likewise, Staff seeks to have the utility investors, and not the customers, donate to the various charities. The charitable contributions would cost each shareholder 2.5 cents per year.

The Commission has allowed utilities to include charitable contributions as an above-the-line item since about 1970. Inasmuch as Staff has not demonstrated any change in circumstances, the Commission policy will be followed.

Advertising Expenses

Embodied in the test year expenses are informational and institutional costs of $755,982 as shown in the table below. The various kinds of advertisements are segregated into two groups. Group A, which includes conservation, safety, information-service and area development will be discussed first. Conservation advertisements consisted of displays, booklets, demonstrations and bill inserts aimed at urging and educating

customers to use less energy. Likewise in the area of safety, customers are educated to a variety of potentially dangerous utility related situations that have accounted for deaths and injuries each year in this country. Informational-service represents money spent to inform customers in obtaining, maintaining and properly utilizing their service, for example, how to identify a meter reader, or how to avoid unnecessary service calls. Finally, area development funds are spent to encourage the upgrading of certain areas.

Turning to Group B items, the first, information-company, includes costs to present general information about RG&E's problems, solutions, and subjects of interest to its customers, such as, protection of the environment and explanations of the operations at the Ginna nuclear plant. The education/technical, energy cost, and community categories cover costs for production of technical specification for contractors, an explanation of rising utility costs and advertising assistance to community groups, respectively.

Appendix I

Advertising Expenses Included in the Test Year by RG&E

Group A	
Conservation	$258,524
Safety	108,788
Information-Service	87,276
Area Development	22,140
Subtotal	476,728
Group B	
Information-Company	180,491
Education/Technical	6,154
Energy Cost	43,104
Community	49,404
Unexplained Amount	101
Subtotal	279,254
Total	$755,982

Genesee would allow only $100,000 for advertising to cover the cost of conservation and required billing or rate information.

Staff and the CPB, relying on the *Statement of Policy on Advertising and Promotional Practices of Public Utilities*, issued February 25, 1977, would limit advertising expenses to 1/25 of one percent or $77,500 for the electric department and $45,730 for the gas department. Staff selected the minimum amount, not on the basis of an analysis of the specific characteristics and circumstances of RG&E, but because Staff felt it is the company's burden to justify any amount above the minimum.

RG&E argues that Staff's proposed adjustments (Item 5) would ignore and is contrary to the company constitutional rights: to communicate with its customers and to manage its own business

by determining what and how much advertising is necessary. If Staff's position is accepted and the company must cover both advertising and capital costs with an allowance for stockholders equal to the minimum cost of capital, RG&E explained that it must either fail to recover the cost of capital (i.e., be subject to confiscation) or refrain from advertising (i.e., be denied freedom of speech).

Furthermore, RG&E claims that the $755,982 of advertising costs are an essential and necessary cost of doing business and should be allowed. The company maintains that its personnel are experts in the field of generation, transmission and distribution of power, that they should keep the customers informed of the utilities' operations, and that customer disaffection, which arise from a seemingly arrogant, silent utility, would soon translate into a higher cost of business and, in all probability, a lower quality of service. It is the managerial judgment of RG&E that customer understanding and acceptance manifest themselves in such things as less vandalism, reduced collection costs and less emotional opposition to facility siting.

The constitutional rights of RG&E do not permit it to undertake an unlimited advertising campaign at the expense of its customers. Since it is a public utility, the rights of RG&E to advertise at the expense of customers must be kept within reasonable bounds and it is the function of this Commission to determine what is reasonable. The Commission set forth various guidelines in its policy statement to determine if advertising costs are reasonable and a range of the allowed expense, expressed as a percent of operating revenues, in which the total costs would, in all probability, fall.

In the Commission's *Statement of Policy on Advertising on Promotional Practices of Public Utilities*, it is stated that the costs of some forms of utility institutional advertising clearly are in the public interest and their costs are a legitimate expense

of doing business, which are properly recoverable in rates. The Group A advertisement falls within this class and will be allowed as a test year expense. Thus, the $476,728 will be allocated to the gas and electric departments in proportion to the advertising expenses claimed by RG&E. The Group B items are examples of the large middle ground of institutional advertising that fall somewhere between that clearly beneficial to customers, and that which is clearly political or controversial. These expenses should be limited to 1/25 of one percent of the adjusted revenues or $122,148, the lower limit established for all advertising costs in the Commission policy statement, since a separate allowance is recommended for the Group A expenses. In summary, the test year operating income will be increased $146,887 for electric and $10,219 for gas (Item 5).

Contractor's Expense

During 1976, RG&E completed its conversion from manufactured gas to natural gas. The test year expenditures were $722,000, including $624,700 for payroll and transportation costs, which will be a continuing expense, and $147,300 for contractors and materials and supplies, which are nonrecurring. Staff proposes a downward adjustment to expense of $147,300 (Item 6) to remove the nonrecurring costs. Staff observed that the 1978 forecasts show a decrease in all contractor and material and supplies costs of $238,000 to $5,503,000.

In its last gas rate case[1] RG&E sought approval of the Commission to defer and amortize the same costs of conversion. The Commission rejected the company's application on the basis of Staff's arguments that the conversion costs were not unusual, incremental or distortive. RG&E claims that Staff's position in

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[1]*Rochester Gas and Electric Corporation* 16 NY PSC ___ (Examiner's Recommended Decision, Cases 26848 and 26849, mimeo p. 65, issued January 7, 1976).

the instant proceeding is contradictory to its position in the last case to the detriment of the Company.

The mere fact that a cost is nonrecurring is not reason enough to exclude the expense from consideration in establishing rates. Nonrecurring costs of this nature are a necessary cost of doing business and should be reflected in the rates. The $147,300 of expense is not large enough to warrant amortization; hence, the test year will not be adjusted. Since an attrition adjustment based on the 1978 forecast is recommended in this report, the expected decrease in contractor and material and supplies is reflected in that adjustment.

Amortization of Reserve Deficiency

RG&E seeks to amortize the approximately $4.6 million or 14.6% deficiency in the gas department's depreciation reserve over 20 years. Thus the company proposes a $230,000 annual increase in depreciation expense, plus the related rate base adjustment.

The deficiency in the reserve was attributed to the company's adoption in 1972 of service lives which are shorter than those indicated by the mortality studies. For example, while the mortality studies indicate lives of 70 years for mains and 42 years for services, RG&E with Commission approval reduced the average service lives of mains to 55 years and services to 35 years. Staff noted that the use of service lives shorter than those computed by the mortality studies, which are based upon past experience, is not unreasonable in view of the tightening gas supply situation.

However, Staff recalculated the theoretical reserve for seven of the plant accounts (comprising 91.5% of the plant in service) based on the lives indicated by the mortality study and found that the deficiency at December 31, 1975 was then only $132,823. The utilization of the service lives shorter than those based on

actual experience created the deficiency which the company now proposes to amortize.

Staff opposes the company's adjustments to amortize the reserve deficiency as reflected in Items 7, and 19 not only because of the way it was instantly created, but also because RG&E's use of the shorter lives should gradually eliminate the deficiency. This gradual elimination is confirmed by actual experience as demonstrated in the table below, which shows the reserve deficiency for RG&E's gas division for the past few years, adjusted to be comparable.

	Reserve Deficiency	
Year	Amount	Percent
1972	$5,034,668	21.1%
1973	$5,161,270	19.7%
1974	$4,746,581	16.4%
1975	$4,584,641	14.6%

Employing a straight line trend analysis, it is estimated here that the gradual disappearance proffered by Staff would take about 30 years. If the company's amortization were adopted, the deficiency would be eliminated in approximately 11 years. The actual lives as demonstrated in the mortality study are based upon past experience which may or may not be an accurate expectation of future lives. After considering current factors expected to influence the future lives, the Commission approved RG&E's use of shorter lives which are known as service lives. RG&E's review of various service lives is proper and in fact encouraged by the Commission. The resulting deficiency in the depreciation reserve represents monies which are owed the company by its customers who have been using the plant. The deficiency should be reduced as rapidly as possible without imposing an undue burden upon ratepayers.[1] Since the company

[1]Orange and Rockland Utilities, Inc. 15 NY PSC 1387, 1396 (Opinion No. 75-21, 1975).

proposal would increase revenues by only 0.2%, Staff's adjustments should not be accepted.

Wages and Salaries

To determine the reasonableness of RG&E's electric labor costs, the CPB compared the company's average wages and salaries per employee to all other electric or electric and gas utilities in New York, New Jersey and Pennsylvania, with more than 1,000 electric department employees, as shown in the summary on page 23. Although the wage and salary comparison is based on 1975 data, a 1976 study would probably not be more favorable for RG&E since its employees received an average increase of 11.1% during the intervening year.

The CPB claimed that labor costs of RG&E were excessive and should be reduced by $1,635,000 and possibly $2,957,000, depending upon the comparison group of utilities chosen, to ensure that wages and salaries are maintained at a reasonable level.

Genesee observed that RG&E's rate of pay led or was among the highest in the community of Rochester, which includes major corporations such as Eastman Kodak, General Electric and divisions of General Motors. In support of its statement, Genesee presented a wage comparison for nonexempt employees of 63 local firms; a reproduction of the study is also shown on the next page.

According to Genesee, a public utility should not be a wage leader in a community of sizeable major corporations because of the unique position a gas and electric utility holds. Thus, Genesee asks that RG&E alter its wage position in the community and that the 1978 wage increase not be included in the rates to be established in this proceeding.

The company noted that the group of utilities comprising CPB's study did not include RG&E itself. If the same methodology were employed in a rate case involving the New York State Electric & Gas Corporation, for example, the average direct compensation level for the New York State group of electric utilities would be $16,972, or $421 more than the CPB proffered average in the instant proceeding.

RG&E not only criticized the methodology but also the basic data employed by the CPB. The company observed that the CPB study does not take into account, and hence does not compensate for, possible differences among the companies in reporting data, other indirect compensation, abnormalities in year-end employee levels, use of outside contractor services, payroll charged to construction, quality of service, employee skill mix, cost of living in the utility service area, and management mix. Other possible differences noted were in amount of overtime pay reflected in the 1975 data, in employee longevity (i.e., the same or lower pay scale can, given greater longevity, result in higher average pay); and in state tax levels.

In view of the many shortcomings noted by RG&E, the study submitted by the CPB cannot be relied upon to support the claimed wage adjustment. The comparison submitted by Genesee unfortunately addresses a very small portion of RG&E's labor force. However, the company accepted a Staff adjustment which eliminates the 1978 wage increase and associated benefits. Instead of an adjustment based upon an estimated amount, it is recommended that Staff's proposal be accepted, i.e., RG&E file for rates to become effective on short notice to recoup additional labor costs when they become known.

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Comparison of RG&E's Wages and Salaries Per Employee To Other Major Utilities for 1975 — Per CPB

Company	New York New Jersey and Pennsylvania	Non-Large City Electric Utilities	New York State Electric Utilities	R.G.&E.'s Neighboring Electric Utilities
Consolidated Edison	$16,547	—	$16,547	—
Duquesne Light Co.	16,247	—	—	—
Long Island Lighting Co.	17,421	—	17,421	—
Philadelphia Electric	18,284	—	—	—
Public Service Electric & Gas	16,246	—	—	—
Allegheny—West Penn Only	15,395	$15,395	—	—
Atlantic Electric Co.	15,516	15,516	—	—
Central Hudson Gas & Electric	16,214	16,214	16,214	—
General Public Utilities	15,590	15,590	—	—
New York State Electric & Gas	15,354	15,354	15,354	$15,354
Niagara Mohawk Power Corp.	16,810	16,810	16,810	16,810
Orange and Rockland Utilities	17,449	17,449	17,449	—
Pennsylvania Power & Light	15,798	15,798	—	—
Average	$16,374	$16,016	$16,632	$16,082
Rochester Gas & Electric	$17,393	$17,393	$17,393	$17,393

Comparison of RG&E's Hourly Wage of Nonexempt Employees To 63 Other Major Industries in Rochester As of October 1976 — Per Genesee

Position	RG&E Average Pay	Standard Average Community Pay	RG&E Rank
Drafter, layout	$8.95	$6.48	1st
File clerk	$4.77	$3.79	1st
Nurse, industrial	$7.51	$6.04	1st
Payroll clerk 1	$6.77	$5.23	1st
Receptionist	$5.68	$4.52	4th out of 28
Telephone operator	$4.97	$4.41	4th out of 27
Secretary 2	$6.62	$5.05	4th out of 34
Janitor	$5.45	$4.46	6th out of 46
Secretary or Senior Steno.	$6.07	$4.58	1st
Comp. Op. 2	$7.10	$5.19	1st
Technician 4	$6.63	$4.92	1st
Truck driver	$6.70	$5.40	2nd out of 28

Appendix I

Productivity, Escalation and Attrition—Introduction

Inasmuch as RG&E's test year is 1976 and the first full year the proposed rates would be in effect is 1978, the various parties seek to adjust the test year for productivity improvements, escalation of costs and attrition occurring between 1976 and 1978. Each of the adjustments is discussed below.

Productivity

Three types of productivity studies were presented, including specific improvements expected in the near future, labor productivity studies and a total factor productivity study. The specific improvements presented by the company would result in savings of $127,600 for the electric department, and $100,000 for the gas department; both amounts were reflected by RG&E in the test year and in the forecast year 1978.

The company also presented a labor productivity study comparing RG&E to the gas and electric industry as prepared by the Bureau of Labor Statistics. In 1975, the index, which has a base year 1967, showed that industry-wide output per employee was 131.0 or less than RG&E's 134.4. Since 1965, the first year in the study submitted, the company also showed a greater rate of improvement than the industry. However, if the studies are confined to the years 1971 through 1975, a comparison shows the RG&E's index declined an average 0.28% per annum, while the industry rose 0.99% per annum. These indices should not be interpreted as representing only labor's contribution to production, but rather as reflecting the interaction of many factors in addition to labor.

Genesee criticized RG&E's study on three grounds: (1) because the number of employees does not include contract labor, productivity is overstated; (2) since the output per employee includes purchased power, the productivity is again overstated;

and (3) inasmuch as the indices only show relative rates of improvement, the productivity of RG&E cannot be compared to other utilities at any one point in time. Thus, a company with poor productivity would show greater gains than a more efficient utility.

According to Genesee, RG&E's productivity is poor because it has the highest per-customer expense of the New York State's private utilities for customer service and sales promotion, administrative and general expense, and next to the highest transmission and distribution expense.

Genesee would reduce electric expenses by $4,165,000 and gas expenses by $883,000 to compel RG&E to achieve Genesee's desired productivity gains, for example, a 10% reduction in transmission and distribution expenses.

In addition to RG&E's labor productivity study, Staff presented a productivity adjustment which brings the 1977 cost of labor into phase with the 1977 sales. Staff divided the 1977 labor expenses by the ratio of 1977 to 1976 sales. Since sales increased in 1977 over 1976, the labor expense was reduced by $208,000 (Item 8) which Staff claimed is the productivity improvement.

Staff adjusted RG&E's 1976 labor costs by excluding the cost of employees whose wages were capitalized, transferred to the steam department, and devoted to appliance sales and by adding the 1977 wage increase and the expense of employees to be hired in 1977. In addition, Staff adjusted the 1977 energy sales to exclude sales for resale; to increase residential output for 1977; and to eliminate double counting productivity improvements arising from the normalization of Ginna Station operations.

According to RG&E, Staff's productivity adjustment is inappropriate inasmuch as Staff could not identify a specific expense item that could be decreased, and because the ad-

justment double counts against the company. RG&E argued that Staff looks forward to pick up a possible revenue increase but ignores related expense items which accompany the revenues.

The third study, total factor productivity, was presented by the CPB to measure the overall productive capability of RG&E. Considered in the calculation of total factor productivity were sales on the output side, and on the input side the costs of labor, capital, fuel, purchased power, and materials and supplies, which was a residual variable intended to cover all expenses not accounted for by the other variables. For the period 1964 through 1976, adjusted to remove the abnormal year 1970 when the Ginna nuclear plant came on the line, the total factor productivity rate was estimated by the CPB to be 2.25%.

The CPB computed the productivity gains to be $4,760,000 between the midpoint of the test year July 1, 1976, through the midpoint of the first year the new rates would be in effect July 1, 1978. The $4,760,000 is not based on the 2.25% but rather 1.22% which excluded the capital input and thus was said to reflect only gains in productivity related to expenses. The CPB's adjustment was computed to represent productivity gains beyond what the company reflected in its test year.

RG&E and Staff noted deficiencies in the CPB's study including the use of sales for resale in the output and ignoring the improvements in the quality or skill of the labor input. Since sales for resale are a significant portion of RG&E's total output (about 20% in 1976), the total factor productivity would be subject to the vicissitudes of other utilities generating activities. Inputs such as distribution costs, which are not a part of the cost of sales, for resale, would erroneously reflect the productivity gains of these sales.

Since the CPB deflated labor costs to a base year and ignored improvements in the skill of the labor force, the company claims that the total factor productivity ratio is overstated. According

to RG&E, the results could be significant in view of the addition of more skilled employees to the utility industry over the past decade. For example, the complexion of the work force has changed due to the increasing sophistication need by a utility labor force to carry out the nuclear and environmental requirements.

Furthermore, RG&E objects to CPB's application of the total factor productivity rates to the operating revenues because the revenues reflect such items as property taxes and federal income taxes which were not included in the total factor productivity study. In other words, under the CPB proposal, RG&E would be expected to have productivity improvements on such taxes.

Finally, RG&E maintains that CPB's use of years prior to 1971 in the total factor productivity study is improper because it includes years outside the new energy era heralded by the Arab oil boycott. In fact, if the study was confined to a more current period, 1971 through 1976, the total factor productivity would be only 0.38%.

It is recommended that the CPB's study not be used to measure productivity improvements in view of the deficiencies pointed out by Staff and RG&E and because it is based on past data extrapolated to the future. On the other hand, Staff's adjustment is predicated on future wages and future sales. RG&E's criticisms that Staff's productivity adjustment ignores related expense items is without merit since Staff also accepted the 1977 wage increase. In addition, no specific item of expense need be decreased as claimed by the company. Productivity improvements can arise by allocating fixed costs to more units of energy sold, which is the basis of Staff adjustment. Item 8, the $208,000 increase in operating income is accepted.

Appendix I

Escalation

RG&E seeks estimated increases in test year operating expenses arising from inflation in the amount of $2,250,000 for the electric department and $568,000 for the gas department. For purposes of discussion, only the electric department will be mentioned; the amount for the gas department was computed in a similar fashion. For two years, the company applied a 6% annual inflation rate to $18,750,000, the test period electric operating expenses exclusive of expenses which were adjusted for known changes. In arriving at the 6% inflation rate, the company considered its normal budget analysis of cost escalation to be expected for the purchase of various material and services. This analysis is based upon the purchasing department's review of historical data, revised price lists and direct contacts with suppliers. RG&E also considered the generally published projections of the inflation rate.

According to the CPB, the inflation index should be 5.6%, the company incorrectly applied its inflation index, and only one year of inflation should be allowed. After reflecting these three adjustments, the CPB maintains that RG&E's escalation adjustment should be reduced by $1,913,000 for the electric department.

Since one of the sources the company relied upon to estimate inflation at 6% revised its projection of inflation to 5.6%, the CPB contends that the new rate should be employed. Rather than apply the inflation rate to a select class of expenses as the company did, the CPB asserted that the inflation rate should be applied to all expenses other than fuel since an inflation index by its nature is a composite rate, and then known cost increases should be subtracted. CPB's reason for limiting the 5.6% rate of escalation to one year is that escalation is so speculative that an adjustment more than a year beyond the end of the test year would be inappropriate.

The CPB's rate of inflation is not accepted because, first, it is only a part of the basic data used to support the 6.0% inflation rate and, second, inflation is on the rise—the recent consumer price index was revised upward to 6.7%. The CPB's method of applying the inflation rate is also unacceptable since it results in applying a uniform increase to all expenses. On the other hand, RG&E's methodology assigns known increase to the expenses and employs the less accurate general rate of inflation methodology to the remainder. While there is a degree of speculation involved in projecting future expenses, it should be kept in mind that rates are also being set for the future and the two must be kept in phase to provide the rate of return recommended herein.

Staff would decrease the company escalation adjustment by $594,652 in the electric division (Item 9). Staff removed from the test period electric operating expenses of $18,750,000, the cost of advertising expenses and contractor services, $488,645 and $4,466,790, respectively. According to Staff, the Commission now prescribes that most types of advertising be based on a percentage of revenues; therefore escalation in advertising costs should be computed as a percentage of additional revenue requirement.

The historical expenses for contractor services since 1973 are shown in the table below. Although RG&E uses the services of about 70 major contractors each year, the quantities of contracted work may vary to achieve an economical mix of company labor and contract labor. In the absence of a study to determine the amount of contractor service required in 1977 and 1978, Staff concluded no escalation allowance for contractor services should be allowed since normal fluctuation in the ratio of company labor to contractor labor may more than offset escalation of costs for contractor services.

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Cost of Contractor Services

Year	*Amount*
1973	$3,851,811
1974	4,599,249
1975	4,034,300
1976	4,466,790

RG&E noted that it supplied Staff with forecasts of contractor expenses which Staff did not utilitze. Instead, Staff presented past costs to justify the exclusion of the cost of contract services from the escalation adjustments.

It is recommended that the allowance for escalation and advertising costs, which are discussed more completely in a separate section of this report, be computed in a consistent manner. Thus, $476,728[1] of the advertising cost will be escalated at 6% per year and the remainder will be tied into the additional revenues.

Turning to the cost of contractor services, the company, which has the burden of proof, did not demonstrate that those costs were forecast to increase in the future; therefore Staff's adjustment is accepted.

Attrition

Although RG&E did not request an allowance for attrition in its initial filing, it sought an allowance of about seven million dollars on rebuttal. Because of the company's late request for attrition, Staff opposed such an allowance on procedural as well as substantive grounds. To place the procedural objection in proper perspective, a history of the request for attrition is necessary.

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[1]The $476,728 is the combined advertising cost. It was allocated to the departments on the basis of RG&E claimed advertising costs or $381,884 to electric and $94,844 to gas.

Appendix I

As noted, RG&E's prefiled evidence did not contain an adjustment for attrition. However, the Commission, by order served on December 28, 1976, directed the company to submit operating projections for 1977 and 1978 within 30 days of the receipt of the order. RG&E provided the material on January 28, 1977. In response to a request by Genesee, the company submitted on April 26, 1977 a computation of an attrition allowance, which RG&E adopted as an attrition adjustment in its rebuttal case.

Staff contends that it is the responsibility of the company in its initial filing to sustain the burden of proof that the use of a historical test year as adjusted properly anticipates the expected results for the first full year of new rates.

Although Staff is correct that the attrition adjustment claimed by RG&E should have been prefiled at the outset of the instant proceeding, the adjustment will not be barred for that reason inasmuch as Staff had access to the underlying data, which consists of the 1977 and 1978 projections, for a sufficient period of time to complete its investigation.

Turning to the substance of the adjustment, RG&E requests an allowance of 0.96% in the electric department because the rate base is expected to increase at a faster rate than available earnings. The company projects an increase in electric rate base of about $69.6 million or 17% from 1976 to 1978. It was observed that $22.6 million is related to Ginna plant additions ordered by the Nuclear Regulatory Commission, including safety regulated equipment to control a possible break in the steam lines outside the containment vessel, a volatile water system resulting from Westinghouse's change in water chemistry specifications, and an upgrading of security. However, in the gas department, the company concedes that there will be a gain of 0.36% since there are no major additions to rate base.

Appendix I

The underlying data for the attrition adjustments consisted of projections of income statements and rate bases for the years 1977 and 1978. The 1977 projection is, in fact, the company's operating budget, which was prepared on a monthly basis by the 63 departments of the company. On the other hand, 1978 was developed on an annual basis from a trend model which RG&E utilized for long-range planning. The projections assume full receipt of the requested rate relief effective December 1, 1977 and reflect the company's proposed interperiod tax allocation for the Oswego No. 6 and Nine Mile Point No. 2 generating facilities. Appendix B sets forth a summary of the company's test year and forecast years and the attrition computations.

Staff in its initial brief pointed to a number of flaws in forecast expenses and rate base to demonstrate the unreliability of the company's projections. Staff criticized the forecast year 1978 for unexplained changes in payroll taxes and fringe benefits and for not including an allowance for slippage in production and common plant additions. Although no dollar adjustments were provided, it is estimated here that they would have a minimal impact upon the attrition factor because the net effect of the changes in payroll taxes and fringe benefits is an increase of about 0.2% and the great bulk of expenditures for production plant additions was actually spent prior to March 31, 1977.

For other items, Staff and the CPB provided specific dollar adjustments to the forecast. The discussion below will be limited to the electric department since it is the cause of the attrition. However, where appropriate, adjustments will be made to both the electric and gas divisions.

Rate Base

The CPB claims that the company's electric rate base is overstated by $5,138,000, in 1978, inasmuch as RG&E employed

the rate base without adjustment for the capitalization. The CPB derived the overstatement by applying the same ratio of capitalization to rate base it proffered for 1976 to the company's 1978 rate l se. To be consistent with the adjustment to the 1976 test year, the CPB proposal will be accepted; however, the recommended ratios will be employed. Thus the 1978 rate bases will be reduced $4,761,000 for the electric department, and $1,080,000 for the gas department.

Staff observed that the Sterling related projects included in 1978 plant in service in the amount of $5.6 million should remain in construction work in progress until Sterling goes into service. Staff's adjustment is accepted.

Sales Forecast

RG&E projected residential sales to grow by 3.3% in 1977 and 5.9% in 1978. In 1977, the company forecasts include 600 new electric space heating customers out of a total of 2,500 new customers. RG&E traditionally had a low saturation of electric space heating customers. Yet of the 2,546 customers added in 1976, some 2,328 were space heating customers. This trend continued in January and February of 1977; the number of space heating customers increased by 332.

Staff noted that residential sales are increasing faster than forecast by the company because of unexpected growth in the number of electric space heating customers. For 1977, Staff projected 2,800 new residential customers including 2,240 space heating and 560 regular customers. Staff based its projections on a review of Rochester's Chamber of Commerce bulletins which noted that a recovery in the local housing industry may be underway as indicated by the recent increases in building permits and construction contracts. In addition, Staff pointed to the recent easing of mortgage interest rates and the low vacancy rates for apartments, all of which indicated a need for renewed

activity in the single houses and apartments. Staff also considered the normal growth in usage per customer.

Thus, Staff forecasts increases of 4.1% and 5.9% in residential sales for 1977 and 1978. The revenue effects of Staff's addition of residential sales are increases of $469,000 in 1977 and $461,000 in 1978. However, the overall effect on revenues is minimal since an increase in residential sales would decrease sales to other utilities. Staff reviewed the sale projections of other classes of customers and found them reasonable.

CPB maintains that the 1977 and 1978 revenues are understated by $1,607,000 and $1,097,000, respectively. These figures are based upon an extrapolation of the average growth rate from 1972 through 1976 (excluding the abnormal year 1974) to 1977 and 1978.

The CPB's sales projection are not accepted because they represent mere extrapolations of past sales. On the other hand, Staff's projections are appropriate since Staff looks to the future market for such sales. No adjustment is required.

Other Expenses Forecast

Other expenses is a term given to a group of expenses, similar to the escalation adjustment discussed on page 29, for which no detailed breakdown of cost projections was presented. The CPB repeated its escalation argument that an inflation rate of 5.6% should be applied to other expenses which would decrease expenses by $1,966,000 in 1977 and $861,000 in 1978. The CPB's adjustment should not be accepted for the same reason as stated in the discussion of the escalation adjustment.

Staff observed that 1978 other expenses are $1,645,000 higher than in 1976 even though the 1976 figures were escalated to represent 1978. The 1978 other expenses will be reduced by $1,645,000.

Appendix I

Wages and Salaries Forecast

The 1978 figures include an estimated wage increase effective February 1, 1978 as well as increases in directly related payroll fringe benefits in the amount of $2,420,318 for the electric department and $1,011,114 for the gas department. In view of the recommendation in this report allowing RG&E to file rates to become effective on short notice for the wage and benefit increases when they become known, these increased costs should be excluded from the 1978 forecast year. For the same reason, the CPB's proposal to limit the projected increases to specific amounts need not be discussed.

Staff also noted that the electric department wages and salaries for 1978 are $634,000 greater than 1976 amounts. The company observed that the gas department 1978 wages decreased by $188,000 and the electric and gas divisions combined wages and fringe benefits increased only $141,000 over 1976. It is recommended that Staff's adjustment not be accepted because it does not address wages and benefits in their entirety.

Property Taxes

Staff criticized the company's projections of property taxes, which were increased by $1,751,000 or about 7.7% from 1976 to 1978, on the grounds that property taxes are almost impossible to project so far into the future with any reasonable degree of accuracy.

There is a degree of speculation in any projections. Since the rates in these proceedings are being established approximately for the year 1978, and since the projected increase does not appear unreasonable, the company projection of taxes for that year will be employed.

Appendix I

Discussion of Attrition Adjustment

Inasmuch as RG&E employed the year 1978 in computing its attrition adjustment instead of the first full year of new rates, 12 months ending November 2, 1978, the company claimed about two months worth of extra attrition. The attrition adjustment will be modified to prevent an overrecovery. Also the rate increase recommended in this report will be substituted for the company requested rate relief which was used in the projections. After reflecting all of the above adjustments, the attrition factors were recomputed. For the electric division, the revised factor is 0.81%; for the gas division, the attrition factor is negligible.

Interperiod Tax Allocation

RG&E is participating in the construction of two generating stations: Oswego No. 6, an 850 MW fossil unit in which the company will have a 24% ownership interest and Nine Mile Point No. 2, an 1100 MW nuclear unit in which the company will have a 14% ownership interest. The building of both plants is the primary reason for the expected rise in allowance for funds used during construction (AFDC) from $360,490 in 1973 to an estimated $15.6 million in 1978.

Assuming a return on equity of from 12% to 13% in 1978, RG&E's ratio of AFDC to common equity earnings will range from 44.1% to 40.7%. Such high ratios will create adverse financial pressures when RG&E seeks additional capital. Thus, the company proposes to normalize taxes associated with the two generating stations. The effect of RG&E's proposal would be to reduce the 1978 AFDC to about $13.3 million and the ratio of AFDC to common equity earnings to 34.7% which is in the range for the utility industry of 33% through 35%.

More specifically, RG&E proposes to normalize not only the tax deduction benefits, derived from interest on the debt used to

finance those projects of $871,441, which complies with recent Commission decisions, but also the benefits of the property, sales and use taxes—$371,040.

RG&E maintained that the Commission now permits the accrual of AFDC net of taxes for an identifiable portion of construction work in progress[1] in order to improve utilities' cash flow. According to RG&E, the Commission's rationale is to give future ratepayers the benefit of the tax deductions related to construction by charging AFDC net of taxes; and since it is those future ratepayers who will be asked to bear the burden of the interest charges incurred during construction, it is reasonable for them to receive the tax benefits associated with those interest costs.

The company adopts the Commission's rationale and expands its application noting that once recognition is given to the fact that current ratepayers should not enjoy the benefit of reduced federal income tax expense related to the tax deductible capitalized interest on plants whose construction burden is being deferred to future customers, it necessarily follows that the same reasoning would apply to reduced federal income tax expense related to capitalized property, sales and use taxes pertaining to that plant.

Staff observed that the Commission has traditionally followed a flow-through policy regarding income tax deductions and has deviated from flow-through only when extraordinary or statutory circumstances warranted such a departure. The three extraordinary financial reasons, listed by Staff, for allowing an interperiod tax allocation are: improvement of cash flow, improvement of interest coverage, improvement (lowering) of

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[1]The company cites Cases 26887 – *Long Island Lighting Company* (Opinion No. 76-11) issued May 28, 1976 and 26943 – *Niagara Mohawk Corporation* (Opinion 76-23) issued November 16, 1976.

AFDC ratio. Although Staff agreed that further support for an interperiod tax allocation stems from the inherent fairness of giving to the future ratepayers (who must pay for the plant) the associated tax benefits, it argued that such a consideration standing alone is insufficient in light of the essentially unavoidable burden to present ratepayers in the form of higher cost capital engendered by large construction programs.

In light of RG&E's projected ratio of AFDC to total common equity earnings, Staff recommends that the interperiod tax allocation applicable to the debt component of AFDC be granted. Staff opposes, however, the proposed interperiod tax allocation of real property, sales and use taxes (Item 14) because the AFDC to earnings ratio will be minimally affected by an interperiod tax allocation related to these taxes; interest coverage would improve slightly, but there is no coverage problem; and cash flow would increase minimally, but the company does not have a cash flow problem.

The rationale that future ratepayers, who must bear the capitalized cost of property, sales and use taxes, should also receive the income tax benefits is strong enough to support the allocation of tax benefits associated with the capitalized taxes. These allocations need not be further buttressed by a demonstration that cash flow, interest coverage or AFDC ratios must be improved. RG&E's interperiod income tax adjustment is accepted.

Staff's argument that the unavoidable burden to present ratepayers in the form of higher cost capital engendered by large construction programs justifies the denial of the benefits to future ratepayers cannot be accepted since it fails to consider other benefits which are flowed through to the present ratepayers, for example, investment tax credits and long-term debt interest deductions.

Appendix I

Coal Inventory

During 1976, RG&E stocked on an average 161,441 tons of coal and had 25,436 tons in transit. Since the company expects to maintain 210,000 tons of coal in stock in the future, a goal which has been in effect over the past three years, it used the 210,000 ton figure to compute the working capital allowance for coal stock.

Although Staff does not question the desirability of maintaining a 210,000 ton level, Staff doubts that RG&E will reach this amount by 1978 because (1) over the last three years the company failed to achieve it; (2) even with the Ginna plant operating with fewer outages, the fossil generation is estimated to increase; and (3) the Russell Station refuse fuel conversion will be completed by 1979 allowing solid waste to be burned in place of coal.

Staff proposed that the coal stock and coal in transit be normalized by using the average historical levels during the time the 210,000 ton desired inventory policy was in effect and subsequent to the escalation in fuel prices. Thus, Staff reduced the claimed working capital allowance by $1,254,579 (Item 21), including a reduction of $1,227,203 to maintain 170,732 tons of coal in stock and $27,376 to allow for 24,560 tons of coal in transit.

In response to Staff's reasons for doubting that the 210,000 ton level can be achieved, RG&E noted (1) that the desired coal stock was maintained in 1972, and during three months in both 1974 and 1975; and since the company avoids spot purchases of coal for stockpile purposes, major production changes brought about by the Arab oil embargo and the Ginna outage depleted the inventory level; (2) that the company expects to purchase by 1978 enough coal to provide for increased consumption and stockpile restoration; and (3) that the County of Monroe will maintain the solid waste inventory which the company should not rely upon

for maintenance of its emergency fuel stock. Furthermore, RG&E claims that, if Staff's position is accepted, then the company cannot be expected to maintain, on average, a greater inventory.

Since coal is stockpiled for emergency usage, it should ideally never be used. However, if emergencies arise, then the desired coal inventory level will drop. Certainly a company should not be penalized for relying on a stockpile to carry it through emergencies, such as embargoes and major plant outages. Staff's adjustment, which would allow rates to recover the lower inventory level, would have this effect. Staff's adjustment, Item 21, should not be accepted.

Earnings Base in Excess of Capitalization

Staff reduced the company's electric and gas rate bases by $6,618,110 and $1,100,765, respectively, (Item 22) to bring the earnings base into balance with the capitalization. The table on the next page sets forth the companywide capitalization and earnings base as proposed by Staff and as recommended in this report. The excesses of $8,524,690 and $5,238,178 are allocated to the electric, gas and steam department in proportion to their earnings bases.

RG&E opposes Staff's mixture of the daily and monthly averages, the elimination of certain capitalization accounts, and proposed deferred income tax.

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EARNINGS BASE VS. CAPITALIZATION
12 MONTHS ENDED DECEMBER 31, 1976

Capitalization	Per Staff	Adjustments	Recommended
Common Stock	$184,473,203		$184,473,203
Capital Stock Expense	(5,365,755)		(5,365,755)
Premium on Preferred	83,412		83,412
Unamortized Debt Expense	(2,252,507)		(2,252,507)
Retained Earnings	58,776,779		58,776,779
Preferred Stock	91,500,000*	($125,000)	91,375,000
Long Term Debt	292,769,896*	990,437	232,760,333
Premium on Debt	686,486		686,486
Debt Discount	(4,242)		(4,242)
Short Term Debt	15,860,291*	530,909	16,391,200
Customer Deposits	486,550		486,550
Dividends Declared	2,332,558	(2,332,558)	-0-
Sterling Land Contracts	503,461		503,461
Dividends Accrued, Preferred Stock	42,604	(42,604)	-0-
Temporary Cash Investments	(3,785,519)*	743,852	(3,041,667)
Interest Accrued Long Term Debt	-0-		-0-
Interest Accrued, Other	-0-		-0-
Investment in Merchandising and Jobbing	(198,049)		(198,049)
Miscellaneous Paid in Capital	-0-	828,748	828,748
Unappropriated-Subsidiary Retained Earnings	-0-	1,071,350	1,071,350
Total	$635,909,168	$1,665,134	$637,574,302
Earnings Base			
Net Plant in Service	$517,905,265		$517,905,265
Working Capital (F.P.C.)	15,530,503		15,530,503
Deferred Income Taxes	(6,224,087)	($1,621,378)	(7,845,465)
Nuclear Fuel W.I.P.	2,667,644		2,667,644
Preliminary Survey	1,424,674		1,424,674
Prepayments	4,893,146		4,893,146
C.W.I.P. (incl. AFCD)	90,785,037		90,785,037
Oil	4,368,682		4,368,682
Coal	5,188,333		5,188,333
Materials and Supplies	9,399,056		9,399,056
Deferred Investment Credit	(2,315,929)		(2,315,929)
Steam Coal Purchases	811,534		811,534
Total	$644,433,858	($1,621,378)	$642,812,480
Excess Earnings Base	$8,524,690		$5,238,178

*Daily

Appendix I

Daily vs. Monthly Averages

Staff employed monthly balances in calculating most components of capitalization; however, daily balances were used in certain accounts because changes in most types of capitalization, notably external funds such as debt actually exist for a fixed number of days, and the debt holders are paid on that basis.

Staff's use of both daily and monthly balances creates an imbalance between the capitalization and the earnings base. For example, if on the tenth day of the month a utility borrowed $1,000 to purchase and install a certain item of electric plant worth $1,000, under Staff's approach, the plant account would reflect a $1,000 addition but the debt account would only reflect $667. This misalignment would be carried forward into the future when in fact the cost of capital should be based upon $1,000 of debt. Although this accounting example is oversimplified, it demonstrates the type of imbalance present. The daily average will not be accepted. Instead the monthly balance will be used throughout the computation of the adjustment.

Interest and Dividends

Staff claimed that interest accrued on long-term debt—$5,283,922 and interest accrued other—$263,777 are not cost bearing investor provided capital, and eliminated them from the capitalization. The CPB would also exclude dividends declared—$2,332,558 and dividends accrued, preferred stock—$42,604 since they too have a zero cost.

Staff explained that these items appear on the balance sheet by virtue of monthly accrual accounting. For example, each monthly interest expense is debited and the liability (interest accrued) is credited. Since bond interest is paid semiannually, the accrued liability appears on the monthly balance sheet. According to Staff, since rates for utility service are set on an annual basis, these accounts should be excluded from capitalization.

The CPB reasoned that if the four items are included in the capitalization, then they must also be included in the capital structure when the cost of capital is being determined which would reduce the company's overall cost of capital, since the four items have a zero cost. If it were not deemed appropriate to include accrued interest and dividends declared within the capital structure for the purposes of computing the cost of capital, the CPB noted, to be consistent, then it would likewise not be appropriate to include the accrued interest and declared dividend in the capitalization when arriving at a rate base determination based upon capitalization.

Arguing for the inclusion of the four accounts in the computation of capitalization, RG&E maintains that the funds set aside for dividends (for example) which were declared but not, as yet, paid are still available for use by the company and therefore are a proper component of capitalization. Furthermore, RG&E claimed that if the company were on a cash basis, these items would reduce the amount of retained earnings.

Staff and the CPB adjustments should be accepted because the four accounts are not cost bearing, investor provided capital.

Canadea Power Corporation

RG&E argues that two accounts pertaining to its wholly owned subsidiary (Canadea Power Corporation), miscellaneous paid in capital - $828,748 and undistributed subsidiary retained earnings - $1,071,350, should be included in capitalization. In the company's last rate case, the Commission included these two accounts in the computation of capitalization.

Staff opposes the inclusion of the subsidiary accounts because RG&E never requested that plant investment be included in the rate base and if RG&E had, it would not be proper since the original common stock was contributed to the company at no cost.

Appendix I

Despite the fact that the original common stock was contributed to RG&E, the company has retained earnings from its subsidiary which represent an investment along with miscellaneous paid in capital. Of course, if the company originally received the plant at no cost, then RG&E's rate base would not be increased. RG&E adjustments are accepted.

Deferred Income Taxes

In its computation of excess earnings base, Staff employed actual per books data for all accounts except deferred income taxes. Staff substituted the pro forma deferred income taxes reflected in the test year of $6,224,087[1] for the per book figure of $7,845,465 to make the earnings base computation consistent with the rate base computation.

RG&E claims that it is improper to use a pro forma figure on one side of the equation - earnings base and actual figures on the other side of the equation - capitalization. On the capitalization side, the actual retained earnings of $58,776,779 reflect the results of actual deferred taxes recorded on the company's books. If pro forma deferred taxes are substituted, RG&E claims that the retained earnings for 1976 should be recomputed to reflect pro forma tax deferrals. The company's position is accepted.

Capital Structure

The company expects to raise $300 million of outside capital during the years 1976 through 1978 to partially satisfy its $530 million construction program and $22.7 million of maturing long-term debt. Other funding will be provided by retained earnings and short term borrowings. Because of these expected changes and in order to bring the capitalization into phase with

[1]Staff did not eliminate the $598,300 of accumulated deferred income taxes applicable to tax savings on abandoned gas plant.

the new rates sought in this proceeding, RG&E employed the capitalization estimated to be outstanding during 1978. The following table sets forth the overall cost of capital; the only disputed item is the cost of common equity.

RG&E's RECOMMENDED COST OF CAPITAL
Estimated Average at June 30, 1978

Capitalization	Capital Ratios	Cost	Cost of Capital
Long Term Debt	48.0%	7.25%	3.48%
Preferred Stock	13.6%	7.04%	0.96%
Customers' Deposits	0.1%	8.00%	0.01%
Common Equity	38.3%	13.40%	5.13%
Total	100.0%		9.58%

Return on Common Equity

RG&E seeks a 14.52% return on common equity as shown in the table below.

Yield on Moody's Aa Bond Index	9.00%
Risk factor ratio	3.10
Capitalization rate	12.10
Adjustment for MBR of 1.25	1.30
Adjustment for equity ratio	(.59)
Adjustment for flow-through	1.71
Total return	14.52%

The company noted that, since common stock occupies the most junior position in the hierarchy of the capitalization and therefore entails the greatest risk, the cost of the common equity should include a return equal to prevailing interest rates on senior debt, plus additional compensation for the greater risk attendant to the common stock - the risk factor. Thus, the company related the cost of utility common equity as reflected by Moody's Average of 24 Electric Utility Common Stocks to varying bond interest rates, and then adjusted the results to

reflect any investment quality differences between RG&E's stocks and those of Moody's Utility Average.

A 9% yield on bonds was chosen to represent the long-term level of interest rates. It was noted that, although the yields of Moody's Average of Aa Utility Bonds in November 1976 were 8.64%, the yearly averages were 9.13% in 1974, 9.39% in 1975 and about 9% in 1976.

The company's risk factor was said to measure investors' expectations of future earnings and dividends. In order to compute the risk factor from actual market data, RG&E maintained that it was necessary for earnings to increase at the rate generally anticipated by investors over a period of five to seven years, RG&E selected the years 1957 through 1965 as representative of a period during which future earnings were accurately estimated. A review of various Moody's surveys confirms the accuracy of the estimates. Prior to this period, operating companies were divested under the Holding Company Act, and World War Two and the Korean War were responsible for excess profit taxes. Since 1965, regulatory lag coupled with progressive inflation has diminished the returns set by the various utility commissions.

After establishing a relationship between bond yields and returns on equity, the company estimated that the return required by investors is 12.1% when the bonds yield 9%. RG&E incorporated its desired market-to-book premium of 25% which increased the computed return on equity by 1.30%. The company further adjusted the return to account for differences between an average utility and RG&E, i.e., the return was reduced by 0.59% for the company's better than average equity ratio and was increased by 1.71% for RG&E's use of flow-through accounting.

Appendix I

The company's equity ratio of 38.3% is greater than the normal 35%. The difference in the risk between RG&E's and the normal capital structures was measured to be 0.59% by applying a constant overall cost of capital to varying capitalization ratios.

Inasmuch as RG&E uses flow-through accounting under which no liability is recorded for the deferred taxes, its securities are less attractive to investors than securities of utilities employing the more conservative accounting policy of establishing a reserve for deferred income taxes. In 1978, RG&E will not normalize about $4.1 million of deferred income taxes which will increase reported earnings accordingly. On the $620 million projected 1978 rate base, this equals 0.66% in overall return or 1.71% on common equity.

The CPB contends that the risk factor relationship between bond yields and total return proffered by RG&E is unreliable because of the disappointing results of standard statistical tests, i.e., the sum of the squares and the least squares regression analysis. According to the CPB, the results of the sum of the squares demonstrates that the annual estimates derived by RG&E's formula are worse than using a straight average for the total return since the sum of the squares of the variation between actual and RG&E estimates are greater, 398.8, than the sum of the squares or the variation between the actual and the average, 327.8. Also, the CPB noted that RG&E's estimates based on five year moving averages are worse than the annual estimates inasmuch as the difference in the sum of the squares increases by about three times.

A least squares regression analysis was employed by CPB to test the degree of correlation between RG&E's total return and the two independent variables, bond yield and risk factor. The value of R squared is .01589, which means that only 1.589% of the variation in total return is explained by bond yielded risk factor ratios. If R squared equaled zero, none of the variation is

explained by the regression equation; if R squared equaled one, the total variation is explained by the two variables, in the equation.

Staff estimated the cost of common equity for RG&E at 12.8% based upon two analysis: a discounted cash flow method and a study of cost spreads between common equity and long-term debt securities. Under the discounted cash flow method, the cost of equity is determined by combining the yield demand by investors with further growth expectations. The discounted cash flow cost of equity for various stocks is as follows.

Standard and Poor's 425 Industrials	— 12.0%
Moody's 24 Utilities	
Flow Through	— 11.9% to 12.2%
Normalized	— 11.5% to 11.7%
Combined	— 11.7% to 12.0%
Twenty largest electrics in country	— 11.8% to 12.0%
RG&E	— 12.0% to 12.4%

Staff selected 12.4% as the capitalization rate for RG&E in view of the company's large construction program and outside financing requirements. Since RG&E plans three common equity offerings by 1981, Staff adjusted the capitalization rate of 12.4% upward to 12.8% to reflect a market-to-book ratio of 1.06, which allows for flotation pressures and underwriting spread.

In its second study, Staff analyzed the 1976 quarterly spreads between the cost of common equity and long-term debt for the roughly 45 companies listed in Solomon Bros. 100 Electric Utilities which had market-to-book ratios between .9 and 1.10. The study concluded that a 3.2% spread approximates the risk premium for holding common equity vis-a-vis debt. Thus, the cost of common equity would be 12.2% for RG&E since its bonds are expected to yield 9%.

Staff maintains that RG&E's total return need not include adjustments for equity ratio and flow-through accounting.

According to Staff, the company should apply the risk factor ratio to its own bonds, the cost of which already reflects these items. Staff would also reduce RG&E's claimed market-to-book ratio of 1.25 to 1.06. Reflecting these adjustments in the company's computations would reduce the total return to 12.5%.

Genesee computed a return on equity of 12.2% by also employing the discounted cash flow methodology. However, the discounted cash flow concept was applied to ten years of historical data for RG&E rather than a group of companies such as Moody's 24 electrics. Genesee computed a dividend which would allow the market price to increase to the book value of a share by employing the historical ratios of dividend and market price. Since RG&E has consistently paid out 50% of earnings as dividend, Genesee doubled its computed dividend to arrive at the 12.2% return equity. Genesee noted that its return on equity is consistent with studies of investor expectations, i.e., the Fisher-Lorie study.

The methodology employed by RG&E to compute its return on common equity is the same as that rejected by the Commission in Case 26958 - *The Brooklyn Union Gas Company.* Among other things, the Commission reasoned that the relationship for the period 1957 through 1965 between bond yields and average additional risk associated with equity securities is of questionable validity in today's market. The CPB's statistical tests of the company's data confirms the Commission reasoning.

The major difference between the equity return of Staff's at 12.8% and Genesee's at 12.2% is the market-to-book ratios employed - 1.06 and 1.00, respectively. Staff allowed 6% to cover flotation pressures and underwriting spreads. RG&E sought a premium of 25% to cover market pressures to provide a measure of security against periods when earnings decline or fail to provide an adequate return or when unfavorable general market conditions bring pressure on the price of stock. The company

observed that the average annual fluctuation in the market price of its stock was 26% from 1957 through 1975.

Inasmuch as RG&E plans to issue substantial amounts of debt and stock in the near future, recognition must be given to existing market pressures beyond flotation pressures and underwriting spreads. However, the company's 25% market premium is unacceptable since it is a measure of market price fluctuations and not fluctuations from the book cost of stock. It is recommended that an allowance of 15% be employed along with Staff's discounted cash flow methodology to compute the return on equity. Thus, the recommended overall return is 9.58% and the equity return is 13.4%, which was rounded upwards so as not to fall below the recommended 15% market premium.

Electric Rates

Electric service is provided through six service classifications, including SC No. 1 - Residential and Religious, SC No. 2 - General Service - Small Use, SC No. 3 - General Service - 100 kW Minimum, SC No. 5 - Steel Furnace Service, SC No. 6 - Area Lighting Service and SC No. 7 - General Service, 5 kW Minimum. In addition, the company has a number of special contracts with municipalities for street lighting service.

Revenue Allocation Among the Classes

Both Staff and RG&E presented cost of service studies for the electric department. While methodologies, employment of data and judgment differed, both parties agreed that additional revenues should be allocated by increasing on an equal percentage basis each class's (including street lighting) base revenues net of total fuel and PASNY credits. Originally, RG&E proposed a revenue increase of 1.5 times the average for SC No. 5 - Steel Furnace Service, but, later, the company did not oppose a Staff proposal to transfer the two customers served under SC No.

5 to SC No. 3 - General Service, 100 kW minimum. It was noted that the company intended eventually to eliminate SC No. 5 and that the delay would increase the impact of the transfer. Since RG&E would realize a net revenue increase of $45,500 if the two customers are transferred, Staff would reduce the SC No. 3 rates to wash out the gain.

Staff suggests that the rates for street lighting service remain unchanged until April 1, 1978, when all of the contracts will have expired. This would prevent RG&E from charging some customers higher rates than others for the same service.

However, according to Staff, the four month delay in the effective date for street lighting rates will produce an automatic revenue shortfall for the company. Staff proposed to add one-half of the four month shortfall to the company's otherwise approved overall revenue increase. In this way, the company will be made whole for any rate increase granted, over the first two year period following the rate increase.

RG&E has two objections to Staff's street lighting proposals. First, under the Staff proposal it would require at least two full years under the rates determined in these proceedings for the company to recover the shortfall. Yet, RG&E observed that current Commission practice is to set rates for only one year in the future. Second, the company objects to the imposition of the recovery obligation upon all of the electric customers rather than solely upon the street lighting customers.

The City claims that a revenue increase should not be allocated to the street lighting customers because there was no notice of an increase and because the cost of service study does not reflect the latest contract rates. However, if street lighting receives a revenue increase, the City generally agrees with Staff proposals despite its retroactive rate making qualities.

The City's argument that any street lighting tariff rate increase should be delayed until an increase is requested by RG&E

and notice is given to the street lighting customers so that they may have an opportunity to state their views is unacceptable. The notice of hearing stated December 15, 1976, contained the following statement:

> "The Commission may approve, modify, or reject any or all of the proposed tariff changes. Among other things, the Commission may require revisions of the proposed amount of increase applicable to particular types of service or changes in the rates applicable to those types of service for which no increase has been proposed by the company."

In addition to being published, the notice of hearing was actually sent to the counties, cities, towns and villages, within the service territory of RG&E. At various times, the street lighting customers were also informed of the company's pending rate application for street lighting service and the time and place of the hearings.

Turning to the cost studies, the rate of return for street lighting, 4.34%, was less than the systemwide return, 8.49%, in RG&E's study. In Staff's study, the street lighting rate of return was 4.67% compared to the overall systemwide 8.31%. In view of the low rates of return for these customers, the annualization of the new contract rates would not change the proposed revenue allocations even though the City correctly observed, the cost studies do not reflect the full impact of the latest contract rates.

It is hereby recommended that SC No. 5 be eliminated and the revenue increase recommended in this report be allocated among the service classes, including the street lighting class, on an across-the-board percentage basis. Since the street lighting class may not become effective, nor apply to all customers, on the same date as the other service classes, there will be a revenue shortfall. Staff's proposed solution to keep the company whole is unacceptable for the reason noted by RG&E.

Appendix I

Staff's underlying premise, i.e., that all the street lighting customers must pay the same rate, is a concept which applies to customers serviced under a tariff but does not necessarily apply to special contracts. A tariff sets forth the rates, rules and regulations under which any member of the public may take service. Uniform enforcement of the tariff is essential to prevent discrimination. On the other hand, a special contract is a negotiated instrument and the terms under which service is provided may vary from one contract to the next. As soon as the tariff is approved,[1] RG&E should provide street lighting service under the tariff to municipalities whose contracts have expired. Inasmuch as RG&E bound itself to provide street lighting service for a set period of time at a stated rate, the company and not the other tariff customers should bear the financial loss.

Rate Design Within the Classes

The company's present and proposed rates are set forth in Appendix C. In addition, RG&E does not oppose Staff's proposals (1) to extend net-gross differentials to all blocks in SC No. 3 - General Service - 100 kW Minimum and SC No. 7 - General Service - 5 kW Minimum; (2) to implement new primary discount rates for SC No. 3[2] for customers who take service at primary voltages; (3) to continue to provide religious customers with three-phase service by inserting a "grandfather" clause in SC No. 1.

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[1]The statutory suspension period expires January 12, 1978.

[2]The new rates are:

For 4,160 volt service – $ .35 per kW of demand.
For 12,470 volt service – $ .35 per kW of demand.
For 11,500 volt service – $1.00 per kW of demand.
For 34,500 volt service – $1.25 per kW of demand.

Implementation of these proposed rates would produce a revenue loss of about $364,500. Staff proposed that the SC No. 3 demand charges be increased to offset this loss.

RG&E is serving about 120 three phase religious customers at residential rates while requiring other three phase residential customers to take service under the commercial rate. This inconsistency would appear to be in violation of Section 76 of the Public Service Law, which requires equal treatment for residential and religious customers. However, if three-phase religious customers were to transfer to commercial rates, the impact would be severe. On the other hand, to offer and provide service to residential three-phase customers at residential rates could be very expensive since the company would be obligated to provide this service in areas where three phase facilities do not exist. For these reasons, Staff proposed that three-phase religious service customers currently billed at residential rates be "grandfathered" and continue to receive the residential rate and that no new three-phase customers be accepted at residential rates.

Since RG&E does not oppose Staff's adjustment and since they appear reasonable, the proposals should be accepted.

Lifeline Rates

Genesee urges the adoption of a lifeline rate structure to provide relief for residential customers. Genesee estimated that 27.2% or 38,888 families in RG&E's territory earn less than $10,000 a year. Based on annual budgets compiled by Bureau of Labor Statistics for urban areas, four-person families with $9,588 of income need $1,858 for adequate housing (including utilities). Since the average RG&E customer spent $599 on electricity and gas in 1976, Genesee claims that the family would have $1,258 annually, or $105 monthly, left for rent. According to Genesee, this is hardly enough to afford a studio apartment in poor shape.

Although the lifeline rate concept was offered to provide relief to low income customers, it may not because they often occupy

and use the least energy-efficient homes and appliances. The Commission is investigating the lifeline rate concept in the generic rate design case - Case 26806; lifeline rates should not be implemented before the investigation is completed.

Automatic Fuel Adjustment Clause

RG&E's electric tariff contains a fuel adjustment clause which allows the company to pass along increased fuel costs to customers without the necessity of proving that the increased fuel costs just and reasonable. The CPB believes that the operation of the fuel adjustment clause is illegal, unconstitutional, and harmful to consumers' interest. Thus, the CPB requests that the fuel clause be eliminated from the tariff of RG&E.

Inasmuch as the Commission is reviewing the justification for fuel adjustment clauses in a generic proceeding,[1] any action with respect to individual companies should await the outcome of that proceeding. RG&E's fuel adjustment clause should not be eliminated at this time.

RG&E provides gas service through two service classifications, SC No. 1 - General Service and SC No. 2 - Gas Lighting Service. They will be discussed in reverse order. Service under SC No. 2 is limited to locations and units in existence as of April 28, 1972. RG&E proposes to increase the present flat rate from $3.73 to $4.04 per month. The proposed rate reflects the increased annualized cost of purchased gas for the commodity component and an average increase for the noncommodity component.

SC No. 1 is available for all purposes. The present rate consists of a minimum monthly charge of $2.09 and six additional rate blocks. The company proposes to increase the minimum charge by 14.8% to $2.40 which is still below the estimated cost of $3.64

[1]Case 27137 – Proceeding on motion of the Commission to investigate fuel adjustment clauses of electric utilities.

per month. Furthermore, RG&E combined the fourth and fifth rate block and generally increased the rate on a monetary per unit basis.

Since the rate proposals simplify the rate structure, reduce the declining nature of the rate blocks, and move in a more cost oriented direction, RG&E's rate proposals should be adopted.

Preparation of Future Cost Studies

Staff requests that in future cases RG&E be mandated (1) to assign PASNY firm capacity and associated energy to the residential class, (2) to prepare its next cost of service study on the basis of load studies for SC Nos. 3 and 7, (3) to prepare a new stratified load study for SC No. 2, and (4) to include low and high energy use customers in its next residential load study.

The company expressed its willingness to review Staff's proposals, but with one exception did not state it would prepare the studies suggested by Staff. RG&E did not oppose Staff's suggestion to include low and high energy use customers in its next residential load study.

For the other items, the company argues that Staff is in essence substituting its judgment for that of RG&E as if the latter is automatically suspect and the former is infallible; and that company method of estimating loads for SC Nos. 3 and 7 is very accurate to determine the coincident peak for each class; and that the 1966 load study for SC No. 2 is still reasonable and the diverse nature of the SC No. 2 customers would invalidate implicit assumptions associated with stratification.

In adversary proceedings, such as the instant cases, the parties should as a general rule prepare and present their own evidence. Thus, if Staff disagrees with the methodology RG&E employs, Staff should present its own view. Since the information for the assignment of PASNY power is available, Staff should employ

the data in its own studies. However, there are occasions when the general rule cannot be applied. For example, if load studies are unavailable and the collection of such data is within the exclusive control of the company, Staff could not prepare its cost study. In such instances, RG&E should be ordered to conduct new load studies if they are necessary.

Although the company's method of estimating loads may be accurate enough to allocate revenues to service classifications, they offer little help in designing rates within a class. RG&E should be ordered to prepare the cost studies proposed by Staff so that the revenue responsibility can be properly allocated to the customers within a class.

Old House Beebee Station

The steam produced at the Old House Beebee Station is used by both the steam and electric departments. The steam transfer credit is computed based on production costs. No fixed costs are included in the credit. In RG&E's last case, Staff proposed to include a portion of the fixed costs in the expenses allocated to the steam department via the steam transfer credit. The proposal was rejected by the Commission.

Staff proposes no adjustment in this case because the system capacity has not materially changed since the resolution of this issue in the prior proceeding. However, Oswego Unit 6, an 850 MW plant of which RG&E owns 24%, is expected to go on line in 1979. Staff requests that in the next RG&E rate filing (assuming that rates set in the next case will be predicated on operation of Oswego Unit 6) the company be required to substantiate the electric system's continued need for the Old House Beebee capacity, if such need is claimed by the company, and to analyze the financial impact on the steam department which would result if the steam transfer credit were to include an allocation of fixed costs.

RG&E opposes Staff's proposal because the Commission has already resolved the issue and also because Staff (or the company) can review the situation in any future rate proceeding if the facts and circumstances so warrant.

Staff has not demonstrated with any degree of certainty a need for such a study in the next rate case. In addition, Staff should prepare and present its own case unless there are special circumstances which preclude Staff from doing so. The company should not be ordered to prepare the Old House Beebee Station analysis requested by Staff.

Conclusion

The recommended additional annual operating revenues are $15,827,000 for the electric division and $3,743,000 for the gas division. The additional revenues were predicated on the rates of return, attrition allowance, rate bases and operating incomes recommended in this report. Allowances were included for federal income taxes and the following:

	Electric	**Gas**
Injuries and Damages	0.5%	0.5%
Uncollectibles	0.669%	0.619%
Advertising	0.04%	0.04%
Revenue Taxes	4.16%	4.2%

RG&E should reflect the additional recommended revenues in the rate structure as outlined above. Since the discussion of the recommended rate structure assumes the granting of the requested revenues, RG&E should proportionately reduce those rates to produce the recommended revenues. The new rates should be allowed to become effective upon short notice to the customers. Also the company should be directed to cancel the tariff leaves currently under suspension with the exception of the municipal street lighting schedules.

Appendix I

Case 27109 (Gas) should be closed and Case 27108 (Electric) should be continued until a decision on RG&E's street lighting schedules is rendered.

August 5, 1977

WTM:bh

Appendix I

APPENDICES

APPENDIX A

List of Appearances

Sigrid J. Hammond, Esq. Staff Counsel Empire State Plaza, Agency Building #3, Albany, N. Y., for Public Service Commission Staff.

Nixon, Hargrave, Devans & Doyle, Esqs., (by Richard N. George, Esq. and Walter J. Sleeth, Esq.) Lincoln First Tower, Rochester, N.Y. 14604, for Rochester Gas and Electric Corporation.

Huber, Magill, Lawrence & Farrell, Esqs., (by Edward F. Huber, Esq. and Norman Abell, Esq.), 99 Park Avenue, N. Y. 10016, for Rochester Gas and Electric Corporation.

David A. Schlissel, Esq., 99 Washington Avenue, Albany, N. Y. 12210, for State Consumer Protection Board.

Louis Kash, Corporation Counsel (by Francis Coleman, Esq. and Fred Balluff, Consultant), City Hall, Rochester, N.Y., for City of Rochester.

William L. Von Dohlen, Esq., 36 West Main Street, Rochester, N. Y., for Town of Greece.

Lloyd Lill, et al, 8 Prince Street, Rochester, N. Y., 14607, for Genesee Valley People's Power Coalition.

De Graff, Foy, Conway & Holt-Harris, Esqs., (by Algird F. White, Jr., Esq. and Terrence J. Devine, Esq.), 90 State Street, Albany, N. Y. 12207, for Multiple Intervenors.

Appendix I

CASES 27108 and 27109

Rochester Gas and Electric Corporation
Electric Department
Projected Income Statement and Rate of Return
1976, 1977, 1978
(000's)

	1976 Pro Forma	1977	1978
Revenues:			
Customer revenues	$165,579	$176,624	$184,038
Sales to other utilities	22,336	19,689	20,938
Proposed Revenue Increase	—	1,771	20,100
Total Revenues	$187,915	$198,084	$225,076
Expenses			
Fuel			
Nuclear	$ 8,380	$ 10,780	$ 10,497
Fossil	24,009	25,624	28,389
Purchased power	$ 13,783	$ 14,474	$ 15,095
Steam transferred—net	(787)	(652)	(1,036)
Wages and salaries	31,679	31,097	32,313
Direct payroll fringe benefits	7,410	6,682	7,270
Other	24,286	24,628	25,981
Total Expenses	$108,760	$112,633	$118,509
Depreciation	$ 14,308	$ 15,371	$ 17,056
Amortization of other plant	$ 78	$ 78	$ 78
Taxes—Other than income			
Ad valorem taxes	$ 22,630	$ 22,776	$ 24,381
Revenue	6,348	7,565	8,671
Payroll	1,490	1,434	1,883
Total—Taxes—Other than income	$ 30,468	$ 31,775	$ 34,935
Operating income before Federal Income Tax	$ 34,301	$ 38,227	$ 54,498
Federal income tax	$ (3,352)	$ (2,661)	$ (2,427)
Provision for deferred income taxes—Net	1,224	1,827	2,352
Investment tax credit adjustment	3,790	2,708	6,832
Interperiod tax allocation	1,243		3,263
Operating income	$ 31,396	$ 36,353	$ 44,478

Appendix I

	1976 Pro Forma	1977	1978
Adjustment of allowance for funds used during construction	$ (481)	$ (646)	$ (646)
Dividends received from Canadea Power Corporation	120	120	120
Balance for return	$ 31,035	$ 35,827	$ 43,952
Average rate base	$407,006	$435,365	$476,611
Rate of return	7.63%	8.23%	9.22%

Appendix I

CASES 27108 and 27109

Rochester Gas and Electric Corporation
Gas Department
Projected Income Statement and Rate of Return
1976, 1977, 1978
(000's)

	1976 Pro Forma	1977	1978
Revenues:			
Customer revenues	$113,041	$112,244	$112,244
Proposed Revenue Increase	—	777	7,000
Total Revenues	$113,041	$113,021	$119,244
Expenses			
Purchased Gas	$ 65,206	$ 64,331	$ 64,331
Wages and salaries	12,704	12,045	12,516
Direct payroll fringe benefits	2,981	2,679	2,816
Other	5,741	5,115	5,503
Total Expenses	$ 86,632	$ 84,170	$ 85,166
Depreciation	$ 4,388	$ 4,306	$ 4,393
Amortization of Extraordinary Property Loss	$ 83		
Taxes—Other than income			
Ad valorem	$ 5,369	$ 5,394	$ 5,111
Revenue	4,312	4,781	4,972
Payroll	624	606	729
Total—Taxes—Other than income	$ 10,305	$ 10,781	$ 10,812
Operating income before Federal Income Tax	$ 11,633	$ 13,764	$ 18,873
Federal income tax	$ 1,612	$ 2,057	$ 4,609
Provision for deferred income taxes—Net	397	410	288
Investment tax credit adjustment	361	422	434
Operating income	$ 9,263	$ 10,875	$ 13,542
Adjustment of allowance for funds used during construction	$ (24)	$ (27)	$ (27)
Balance for return	$ 9,239	$ 10,848	$ 13,515
Average rate base	$127,292	$128,692	$130,993
Rate of return	7.26%	8.43%	10.32%

Appendix I

CASES 27108 and 27109

Computation of Attrition Factor

	Electric Division	Gas Division	Combined
1) Est. Aver. 1978 Rate Base	$476,611,000	$130,993,000	$607,604,000
2) 1976 Average Rate Base	407,006,000	127,292,000	534,298,000
3) Increase in Rate Base	$ 69,605,000	3,701,000	73,306,000
4) 10.04% Rate of Return	6,988,000	372,000	7,360,000
5) Est. 1978 Balance for Return	$ 43,952,000	$ 13,515,000	$ 57,467,000
6) 1976 Adjusted, Pro Forma Balance for Return[a]	40,885,000	12,684,000	53,569,000
7) Increase in Balance for Return	$ 3,067,000	$ 831,000	$ 3,898,000
8) Required Allowance for Attrition	$ 3,921,000	$ (459,000)	$ 3,462,000
9) Attrition Factor (Line 8 ÷ Line 2)	0.96%	(0.36%)	0.65%

[a]Assumes full receipt of requested rate relief.

Rochester Gas and Electric Corporation

Electric Department

COMPARISON OF PRESENT AND PROPOSED RATES

Service Classification No. 1

Residential Service

Present Rate (Net)			Proposed Rate (Net)		
Energy Charge:			Energy Charge:		
First	12 kWh, or less	$2.17	First	12 kWh, or less	$2.50
Next	288 kWh, per kWh	.0396	Next	288 kWh, per kWh	.0439
Next	700 kWh, per kWh	.0268	Next	700 kWh, per kWh	.0311
Over	1,000 kWh, per kWh	.0226	Over	1,000 kWh, per kWh	.0269
Minimum Charge:		$2.17	Minimum Charge:		$2.50
Off-peak Service:			Off-peak Service:		
First 100 kWh, or less		$3.26	First 100 kWh, or less		$3.70
Over 100 kWh, per kWh		.0162	Over 100 kWh, per kWh		.0184

Present Rate (Net)	Proposed Rate (Net)
Fuel Cost Adjustment: The energy charges above will be increased or decreased when changes from the base cost of $.002374 per kilowatthour occur (as explained in Rule 4.8).	Fuel Cost Adjustment: Same as present.
Increase in Rates and Charges: The above rates will be increased by the applicable percentage shown in Rule 4.9 for service supplied within the municipality where the customer is taking service.	Increase in Rates and Charges: Same as present.

Rochester Gas and Electric Corporation

Electric Department

COMPARISON OF PRESENT AND PROPOSED RATES

Service Classification No. 2

General Service – Small Use

Present Rate (Net)			Proposed Rate (Net)		
Energy Charge:			Energy Charge:		
First	12 kWh, or less	$2.25	First	12 kWh, or less	$2.50
Next	238 kWh, per kWh	.0657	Next	288 kWh, per kWh	.0688
Next	350 kWh, per kWh	.0395	Next	700 kWh, per kWh	.0413
Next	400 kWh, per kWh	.0311	Over	1,000 kWh, per kWh	.0250
Over	1,000 kWh, per kWh	.0198			
Minimum Charge:		$2.25	Minimum Charge:		$2.50
Fuel Cost Adjustment: The energy charges above will be increased or decreased when changes from			Fuel Cost Adjustment: Same as present.		

Present Rate (Net)	Proposed Rate (Net)
the base cost of $.002374 per kilowatthour occur (as explained in Rule 4.8).	
Increase in Rates and Charges: The above rates will be increased by the applicable percentage shown in Rule 4.9 for service supplied within the municipality where the customer is taking service.	Increase in Rates and Charges: Same as present.

Rochester Gas and Electric Corporation

Electric Department

COMPARISON OF PRESENT AND PROPOSED RATES

Service Classification No. 3

General Service – 100 kW Minimum

Present Rate (Net)			Proposed Rate (Net)		
Demand Charge:			Demand Charge:		
First	500 kW, per kW	$4.75	First	500 kW, per kW	$5.90
Next	500 kW, per kW	3.58	Next	500 kW, per kW	4.47
Over	1,000 kW, per kW	2.47	Over	1,000 kW, per kW	3.09
Energy Charge:			Energy Charge:		
First 400 hrs. use of billing demand:			First	200 hrs. use of demand	$.0179
First	500,000 kWh, per kWh	$.0168	Next	200 hrs. use of demand	.0152
Next	500,000 kWh, per kWh	.0156	Over	400 hrs. use of demand	.0122
Over	1,000,000 kWh, per kWh	.0135			

Present Rate (Net)		Proposed Rate (Net)
Over 400 hrs. use, per kWh	.0108	
Minimum Charge: $2.47 per kW of service capacity contracted for, but not less than $475.00.		Minimum Charge: $3.09 per kW of service capacity contracted for, but not less than $590.00.
Fuel Cost Adjustment: The energy charges above will be increased or decreased when changes from the base cost of $.002374 per kilowatthour occur (as explained in Rule 4.8).		Fuel Cost Adjustment: Same as present.
Increase in Rates and Charges: The above rates will be increased by applicable percentage shown in Rule 4.9 for service supplied within the municipality where the customer is taking service.		Increase in Rates and Charges: Same as present.

Rochester Gas and Electric Corporation

Electric Department

COMPARISON OF PRESENT AND PROPOSED RATES

Service Classification No. 5

Steel Furnace Service

Present Rate (Net)	Proposed Rate (Net)
All kWh used between 7 am and 8 pm of each weekday (subject to peak hour restriction), per kWh $.0265	All kWh used between 7 am and 8 pm of each weekday (subject to peak hour restriction), per kWh $.0318
All kWh used between 8 pm and 7 am of each weekday, and on Sundays and holidays, per kWh $.0217	All kWh used between 8 pm and 7 am of each weekday, and on Sundays and holidays, per kWh $.0261
Minimum Charge: $.868 per kW of service capacity contracted for.	Minimum Charge: $1.044 per kW of service capacity contracted for.

Present Rate (Net)	Proposed Rate (Net)
Fuel Cost Adjustment: The energy charges above will be increased or decreased when changes from the base cost of $.002374 per kilowatthour occur (as explained in Rule 4.8).	Fuel Cost Adjustment: Same as present.
Increase in Rates and Charges: The above rates will be increased by the applicable percentage shown in Rule 4.9 for service supplied within the municipality where the customer is taking service.	Increase in Rates and Charges: Same as present.
Peak Hour Restriction: For use between 5 pm and 8 pm Monday-Friday except holidays for the first reading on or after October 15 and for four consecutive monthly readings thereafter, a demand charge of $.868 per kW.	Peak Hour Restriction: For use between 5 pm and 8 pm Monday-Friday except holidays for the first reading on or after October 15 and for four consecutive monthly readings thereafter, a demand charge of $1.044 per kW.

Rochester Gas and Electric Corporation

Electric Department

COMPARISON OF PRESENT AND PROPOSED RATES

Service Classification No. 6

Area Lighting Service

Present Rate (Net)		Proposed Rate (Net)	
Lighting Units:		Lighting Units:	
MV 175	$4.64	MV 175	$5.26
MV 400	8.79	MV 400	9.97
MV 1000	15.35	MV 1000	17.42
Added Facilities:		Added Facilities:	
Wood Pole	$1.80	Wood Pole	$2.04
Wire, per foot	.0075	Wire, per foot	.0085
Fuel Cost Adjustment: The energy charges above will be increased or decreased when changes from		Fuel Cost Adjustment: Same as Present.	

Present Rate (Net)	Proposed Rate (Net)
the base cost of $.002374 per kilowatthour occur (as explained in Rule 4.8).	
Increase in Rates and Charges: The above rates will be increased by the applicable percentage shown in Rule 4.9 for service supplied within the municipality where the customer is taking service.	Increase in Rates and Charges: Same as present.

Rochester Gas and Electric Corporation

Electric Department

COMPARISON OF PRESENT AND PROPOSED RATES

Service Classification No. 7

General Service – 5 kW Minimum

Present Rate (Net)			Proposed Rate (Net)		
Demand Charge:			Demand Charge:		
First	25 kW, per kW	$3.50	All kW, per kW		$4.42
Over	25 kW, per kW	3.25			
Energy Charge:			Energy Charge:		
First	200 hrs. use of demand	$ .0317	First	200 hrs. use of demand	$ .0333
Next	200 hrs. use of demand	.0179	Next	200 hrs. use of demand	.0195
Over	400 hrs. use of demand	.0114	Over	400 hrs. use of demand	.0130
Minimum Charge:		$17.50	Minimum Charge:		$22.10

Present Rate (Net)	Proposed Rate (Net)
Fuel Cost Adjustment: The energy charges above will be increased or decreased when changes from the base cost of $.002374 per kilowatthour occur (as explained in Rule 4.8).	Fuel Cost Adjustment: Same as present.
Increase in Rates and Charges: The above rates will be increased by the applicable percentage shown in Rule 4.9 for service supplied within the municipality where the customer is taking service.	Increase in Rates and Charges: Same as present.

Appendix J
Final Judgment of the Court of Appeals of the State of New York, October 14, 1980

Remittitur Court of Appeals
State of New York

The Hon. Lawrence H. Cooke, Chief Judge, Presiding

No. 432

In the Matter of Rochester Gas and Electric Corporation,
Appellant,

v.

Public Service Commission,
Respondent.

The appellant(s) in the above entitled appeal appeared by Nixon, Hargrave, Devans & Doyle; the respondent(s) appeared by Peter H. Schiff, Public Service Commission.

The Court, after due deliberation, orders and adjudges that the determination appealed from and order of the Appellate Division brought up for review affirmed, with costs, in a memorandum. All concur. Gabrielli, J., taking no part.

The Court further orders that the papers required to be filed and this record of the proceedings in this Court be remitted to the Supreme Court, Albany County, there to be proceeded upon according to law.

I certify that the preceding contains a correct record of the proceedings in this appeal in the Court of Appeals and that the papers required to be filed are attached.

/s/ JOSEPH W. BELLACOSA,
Clerk of the Court

Court of Appeals, Clerk's Office, Albany, October 14, 1980

(SEAL)

Appendix K
Notice of Appeal to the Supreme Court of the United States, December 12, 1980

COURT OF APPEALS
STATE OF NEW YORK

In the Matter of
ROCHESTER GAS AND ELECTRIC CORPORATION,
Petitioner,

-vs-

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
Respondent,

for a judgment pursuant to Article 78
of the Civil Practice Law and Rules.

Index No. 4659-78

Notice is hereby given that Rochester Gas and Electric Corporation, the Petitioner above-named, hereby appeals to the Supreme Court of the United States from the final judgment of the Court of Appeals of the State of New York made in this action on October 14, 1980, affirming the order of the Appellate Division of the Supreme Court of the State of New York, Third Department, which was entered on December 12, 1978. The order of the Appellate Division confirmed as constitutional the determination of the Public Service Commission of the State of New York which disallowed for ratemaking purposes the major portion of Petitioner's communication expenses.

This appeal is taken pursuant to 28 U.S.C. §1257(2).

Dated: December 12, 1980

Yours, etc.,

NIXON, HARGRAVE, DEVANS & DOYLE
Lincoln First Tower
Rochester, New York 14603
(716) 546-8000
Attorneys for Petitioner

To: Clerk of the Court of Appeals,
State of New York
Albany, New York 12207

Clerk of the Supreme Court, Albany County
Albany County Courthouse
Albany, New York 12207

PETER H. SCHIFF, ESQ.
Counsel to the Public Service Commission
of the State of New York
Agency Building No. 3
Empire State Plaza
Albany, New York 12223 .
(518) 474-2510
Attorney for Respondent

Appendix K

AFFIDAVIT OF SERVICE

COURT OF APPEALS
STATE OF NEW YORK

In the Matter of
ROCHESTER GAS AND ELECTRIC CORPORATION,
Petitioner,

-vs-

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
Respondent,

for a judgment pursuant to Article 78
of the Civil Practice Law and Rules.

STATE OF NEW YORK }
COUNTY OF MONROE } ss.:

RICHARD N. GEORGE, being duly sworn, deposes and says:

I am a partner in the law firm of Nixon, Hargrave, Devans and Doyle, Lincoln First Tower, Rochester, New York 14603, attorneys for Rochester Gas and Electric Corporation, Petitioner.

On December 12, 1980 I served the annexed Notice of Appeal to the Supreme Court of the United States on the Public Service Commission of the State of New York, Respondent, by depositing a true copy of the same in a properly addressed wrapper with first class postage prepaid to Peter H. Schiff, Esq., General Counsel, Public Service Commission of the State of New York, Agency Building No. 3, The Governor Nelson A. Rockefeller Empire State Plaza, Albany, New York 12223, in an official mail box under the exclusive care and custody of the United States Postal Service within the State of New York.

All parties required to be served have been served.

/s/ RICHARD N. GEORGE
Richard N. George

Subscribed and sworn to before me
this 12th day of December, 1980.

/s/ ROBERT G. HARVEY
Robert G. Harvey
Notary Public, State of New York
Monroe County, N.Y.
Commission Expires March 30, 1981

Dated and Entered:
December 16, 1980
Office of Albany County Clerk, Albany, New York

Received:
December 15, 1980
Office of the Clerk of the Court of Appeals
Albany, New York

Appendix L
Statement of Policy on Advertising and Promotional Practices of Public Utilities of the Public Service Commission of the State of New York, February 25, 1977

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

STATEMENT OF POLICY
ON ADVERTISING AND PROMOTIONAL
PRACTICES OF PUBLIC UTILITIES

Issued: February 25, 1977

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Appendix L

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

COMMISSIONERS:

Alfred E. Kahn, Chairman, concurring in part and dissenting in part
Edward Berlin, Deputy Chairman
Carmel Carrington Marr
Harold A. Jerry, Jr.
Anne F. Mead, dissenting in part
Charles A. Zielinski

STATEMENT OF POLICY ON ADVERTISING AND PROMOTIONAL PRACTICES OF PUBLIC UTILITIES

(Issued February 25, 1977)

BY THE COMMISSION:

On July 28, 1976, we issued a notice of proposed policy statement and requested comments on the subjects of advertising by utilities and the promotion of electricity sales. We indicated our intention to reexamine subjects covered in our 1972 policy statement on these matters[1] in light of contemporary conditions. We asked interested parties to comment on the items discussed in the proposed policy statement and to offer alternative suggestions on these issues if they so desired.

Over 300 responses to our notice were received. Many of these were brief statements of position from individual consumers; others, including those from most of the utilities, consumer, environmental and other special interest groups, were more comprehensive in scope. Because of the great number of

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[1]*Statement of Policy on Advertising and Promotional Practices by Public Utilities*, 12 NY PCS 108-R (issued June 21, 1972).

responses, no attempt will be made in our discussion to identify the particular views of individual respondents. It is worthy of special mention, however, that we found the responses extremely valuable. They were all carefully considered and evaluated in reaching decisions on the issues presented in our notice.

Although the amount of money spent on advertising by major utilities in this State is a very small portion of their total revenues, the proper extent and content of such advertising and the ultimate responsibility for its cost is an increasingly controversial issue. This Commission has routinely monitored the advertising practices of New York utilities within the framework of the Uniform System of Accounts and the guidelines for rate treatment of these expenditures set forth in our 1972 policy statement, as subsequently amended in individual rate proceedings. Thus, we have established a system of regulation which has provided reasonable assurance that even the minor amounts expended are properly accounted for, so that we can determine whether utility rates reflect only reasonable amounts, expended for proper purposes.

Our 1972 policy statement was issued at a time when the telephone industry was beset with significant service problems, since largely overcome, when the emerging gas supply shortage was first recognized and, of perhaps greatest importance, before the 1973 oil embargo which resulted in severe fuel oil shortages and sharply increased oil costs. While we have, through individual rate and other orders, amended the provisions of the 1972 policy statement where necessary to meet these changing conditions, we have during the past year felt it desirable to have a fresh look, in integrated fashion, at the totality of issues associated with utility company advertising and promotional practices, in the light of circumstances of 1976 and 1977.

Appendix L

Advertising expenses may be subdivided into two broad categories: promotional—advertising intended to stimulate the purchase of utility services—and institutional and informational, a broad category inclusive of all advertising not clearly intended to promote sales.

Promotional Advertising[1]

(1) *Electricity*

The 1972 policy statement contained no restriction on the promotional advertising of electric utilities, explicitly recognizing that those companies had exercised self-restraint in these efforts, most of which were limited to development of off-peak loads. Shortly after the oil embargo, and in response to the reductions in oil supplies, we prohibited the promotion of the use of electricity through advertising or the provision of subsidy and incentive plans. That ban is still in force.

In our July 28, 1976 notice, we requested comments on a proposal to lift the flat ban against sales promotion by electric companies. We listed several competing considerations, some arguing for extension of the ban and others for its relaxation.

Of the responses received on this specific matter, a large number of parties suggested that electric companies be permitted to develop off-peak loads. In addition to the benefits of a limited relaxation that were mentioned in our notice, many of these parties pointed out that development of off-peak load would likely result in a lowering of the unit cost of electricity, due to a greater utilization of existing plant, with a resulting

[1]In addition to establishing the policy set forth below, we will require strict adherence to the accounting classifications of this type of advertising as set forth in the Uniform System of Accounts prescribed for electric, gas and telephone utilities. See Resolution of the Commission: Amendment of 16 NYCRR, Chapters II, III and VI, Article 1, adopted October 24, 1973.

downward pressure on, or at least a stabilization of, present rates. Others observed, as we did in our notice, that where electricity competes with oil, promotion of electricity, if generated incrementally from coal or uranium, could confer the additional benefit of making this country more independent of foreign oil supplies in those cases where oil is the primary competitive fuel.

We recognize now, as the Commission did in 1972, that development of off-peak loads may be beneficial in numerous ways. Increased off-peak generation, however, while conferring some beneficial side effects, also consumes valuable energy resources and, if it is the result of increased sales, necessarily creates incremental air pollution and thermal discharges to waterways. More important, any increase in off-peak generation from most of the major companies producing electricity in this State would not, at this time, be produced from coal or nuclear resources, but would require the use of oil-fired generating facilties. The increased requirement for fuel oil to serve the incremental off-peak load created by promotional advertising would aggravate the nation's already unacceptably high level of dependence on foreign sources of supply and would, in addition, frustrate rather than encourage conservation efforts. We realize, too, that a continued ban on promotion of off-peak electric usage may aptly be described as piecemeal conservationism since promotion of oil for use in heating or internal combustion applications is not similarly proscribed. Nevertheless, conservation of energy resources remains our highest priority. We do not consider it inconsistent with that principle to implement programs that admittedly will be less than optimally effective, in a national context. It is reasonable to believe that a continued proscription of promotion of electric sales will result in some dampening of unnecessary growth so that society's total energy requirements will be somewhat lower than they would have been had electric utilities been allowed to promote sales.

We conclude that the existing ban on promotion of electricity sales should be continued. We recognize, however, that as we move toward more and more widespread adoption of time-of-day rates, it may be highly desirable for companies to publicize those rates, and point out the various ways in which customers may take advantage of them. While this advertising may better be described as informational, we wish to make clear, in any case, that it is our desire to permit advertising of this kind, provided it has the exclusive, or at least preponderant effect of encouraging *shifts* of consumption from peak to off-peak and little or no effect of increasing aggregate sales. For these reasons, we will remain prepared to approve specific proposals by the companies for specifically described programs that meet these criteria. We shall reexamine from time to time our determination to continue, with the limited exception for publicizing time-of-day rates, the ban on promotional advertising should conditions change sufficiently to warrant such a reevaluation. Further, we shall continue to maintain surveillance of all advertising activities engaged in by electric utilities, and where deviations from the requirements of our order are found, we will take remedial action, including adjustments in rate cases, to bring about compliance.

(2) *Gas*

Because of the then emerging and increasingly severe shortage of natural gas, on October 26, 1971,[1] we ordered all gas companies (with the exception of several small companies specially situated) to limit the attachment of new gas customers and the

[1]Case 25766, the *Gas Restriction Case*, 11 NY PSC 1257.

expansion of gas service to existing customers.[1] That order also provided:

> Effective January 1, 1972, all gas distributors subject to the restrictions imposed herein shall cease all promotional activities designed to acquire new gas customers or increase sales of gas to existing customers. Except to the extent indicated below, such prohibition shall apply to all advertising employing mass media, all bill inserts or other direct mailings to customers or others, and all calls by salesmen seeking to obtain or arrange "conversions" to gas space heating or to sell or promote the sale of gas appliances. The prohibition does not apply to:
>
> (a) Service calls to repair existing gas equipment, recommendations relating to the replacement of such equipment, and information relating to such replacement.
>
> (b) Advice directed to existing customers as to how they may achieve the best heating and safety results with respect to existing gas equipment. Use of the mass media or unselective mailings are not an acceptable means of accomplishing this objective.
>
> (c) Direct contact with existing or potential customers for the purposes of encouraging the installation of dual-fuel equipment.
>
> (d) Individual responses to inquiries received by a gas company without prior solicitation.

These provisions were incorporated into our 1972 Policy Statement and remain in effect. We have reexamined these requirements in light of current conditions and conclude that, for the most part, they should remain unchanged. We are, however, concerned about the exception granted in item (c) above. Because additional demand for gas can be created as a

---

[1]Case 25766, the *Gas Restriction Case*, 11 NY PSC 1257.

result of direct contact with potential customers for the purpose of encouraging the installation of dual-fuel equipment we will no longer consider this a permissible activity by gas utilities. Of course, the companies may continue to encourage their existing gas customers to install alternate fuel equipment. In addition, in view of the deepening gas supply shortage, and the essentiality of inducing all customers to conserve; we will no longer permit promotional activities designed to retain existing customers at previous levels of consumption, except in those limited instances where gas companies are permitted to attach new residential load to offset a decline in firm load.

All other provisions of our previous order will remain in effect, as to each gas company covered. Exceptions to this policy may be granted provided a company can clearly demonstrate that it has firm supplies of gas, for the present and near future, sufficient to permit it to engage in some limited form of promotional activity without lessening the supply of gas available to existing customers.

As long as the shortage of natural gas continues, we shall maintain close surveillance of advertising and other promotional activities of gas companies. We shall also continue to require prior submittal of the promotional plans of gas utilities seeking to deviate in any way from our order in Case 25766 as amended here.

(3) *Telephone Companies*

On February 11, 1970, we directed New York Telephone Company to "cease all promotional advertising and all other promotional activities designed to attract additional subscribers or otherwise to increase telephone usage until such time as the company's capacity to provide service exceeds busy-hour requirements throughout the state, except for local promotions in areas where ample capacity exists." Case 25290, *New York*

Telephone Company Service Case, First Interim Order, 10 NY PSC 93. Since adoption of this order, New York Telephone Company's capacity to provide service has improved to the point where it now exceeds busy-hour requirements throughout the state. By order issued in Case 25290 on March 13, 1973, 13 NY PSC 461, we relaxed the promotional advertising restrictions previously imposed "provided that the company will insure that the service sought to be promoted will not burden the subscriber body with an increase in average costs, but rather will tend to reduce the burden of cost which must be supported by the average subscriber."

While the interim order in Case 25290 was outstanding, we considered whether the promotion of yellow pages should also be restricted and we concluded that it should not. Yellow pages promotion may increase telephone usage to some extent, but the major purpose of these directories is to facilitate more efficent use of the telephone by reducing calls to information or to parties unable to assist the caller.

We shall continue the policy on telephone promotional advertsing that is now in effect. Promotional advertising by New York Telephone Company, or by other telephone companies, including radio-telephone utilities, will be carefully scrutinized to assure (1) that adequate capacity exists to provide the service sought to be promoted without adversely affecting existing subscribers; and (2) that the advertising expenditures themselves together with the expansion of the service which they seek to promote will tend to reduce rates for telephone service.

Institutional Advertising

In addition to seeking to promote sales, utilities (like other businesses) engage in "institutional advertising"—a rather amorphous phrase covering all advertising which is not sales promotional in nature. Although our staff has employed some

relatively useful tests in reviewing expenditures for this kind of advertising,[1] the very imprecision of the definition has caused substantial controversy in our proceedings about whether certain kinds should be recovered in rates. Therefore, we believe there is a clear need to reexamine this area, and to establish a policy for treatment of related expenses in rate cases. We consider separately two categories of institutional advertising: (1) civic, political and related advertising activities, and (2) informational and other institutional advertising.

Civic, Political and Related Advertising Activities

It is generally accepted that advertising which states a utility's position on a matter of public controversy necessarily reflects the political views or self-interest of managements or shareholders and should not be borne by ratepayers, whose views or interests may differ. Thus, political advertising—in support of, or opposed to, governmental action of any kind—will not be considered a legitimate cost of doing business for the purpose of determining rates. See *Complaint of Grassroots Action, Incorporated,* Case 26315, April 18, 1973, 13 NY PSC 630. Our amended Uniform System of Accounts reflects this view. All political advertising is required to be recorded below the line in nonoperating expense account No. 426.4. Expenditures recorded in this account are routinely excluded in the ratemaking process.

Our decisions in two recent cases notwithstanding,[2] we shall also include in the category of political and related activities, and therefore payable by stockholders, all advertising which seeks to sway opinion—legislative, environmental, govern-

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[1] *E.g.*, "Is the advertising clearly beneficial to consumers?"

[2] Case 26848, *Rochester Gas & Electric Corporation* (Opinion 76-8, issued April 8, 1976) and Case 26887, *Long Island Lighting Company* (Opinion 76-11, issued May 28, 1976).

mental, consumer or any other kind—to the industry's position on public policy disputes. Utilities, of course, have the right to publish their thoughts on vital issues concerning their operations, but, upon consideration of the comments received in response to our notice, we are now persuaded that it is unfair to impose the cost of disseminating those thoughts onto ratepayers who may or may not agree with them. The expression of a utility's views on a controversial issue may truly reflect its concern for the welfare of its consumers and may make a genuine contribution to a public policy debate; but we believe that it is basically unfair to assess against ratepayers the cost of advertisements urging the adoption of positions with which they may disagree. Therefore, we will no longer sanction the use of sums provided by ratepayers to advance one side of a public controversy. We include in this category expenses incurred in the preparation of materials designed to influence public opinion in the current debate concerning the development of nuclear power. We do not seek by this action to inhibit or discourage participation by utilities in public debates of issues that vitally concern them: we recognize and endorse their right to do so. We simply believe that it is wrong to expect ratepayers to finance that participation.

Further, we shall not permit advertising on matters of public controversy to be included in the printed material that often accompanies the mailing of consumer bills. We believe that using bill inserts to proclaim a utility's viewpoint on controversial issues (even when the stockholder pays for it in full) is tantamount to taking advantage of a captive audience, since the consumer cannot avoid receiving the literature with the utility's message. Regardless of whether consumers read the material, it is basically unfair to subject ratepayers who disagree with the utility's viewpoint to the arguments of the utility through its billing mechanism. A utility company's mailing list provides an available conduit for the easy dissemination of information,

which should be used for the benefit of both the consumer and the company to convey noncontroversial and useful information that will create a better informed public. It should not become a vehicle for dissemination only of the company's views on controversial matters of public policy. Accordingly, we will not permit bill inserts to be used by utility companies for the purpose of advertising their opinions or viewpoints on controversial issues of public policy.

Informational and Other Institutional Advertising

Some forms of utility institutional advertising clearly are in the public interest and their costs are a legitimate expense of doing business. These include appeals for the conservation of gas or electricity; notification of emergency conditions and procedures; instructions in the proper use of the equipment which makes use of the utility's service; information about new rates, new billing practices, or new inspection or meter reading schedules; advice concerning hazards associated with the utility's service; reports on matters of interest to the public concerning the utility's service—such as service difficulties and progress in overcoming them, projections of new capacity additions, plans for new or improved means of providing service, and the like. Expenses incurred by utilities for this type of advertising are clearly properly recoverable in rates.[1]

There is, in addition to purely informational, a large middle ground of institutional advertising that falls somewhere be-

[1]In addition to purely informational advertising, those advertising costs attributable to a utility's effort to upgrade the residential and industrial potential of its franchised territory and to improve the area's overall economic condition are properly recoverable. Advertisements extolling the desirability of the area as a location for job-creating industry would, if successful, benefit all of the utility's customers. Whatever its possible effects on utility rates, its benefits for the economy of New York State clearly makes such advertising a fully acceptable activity by utility companies.

tween that clearly beneficial to customers, and that which is clearly political or controversial. There is advertising, for example, in which a company defends, justifies, or even merely explains and describes its activities. It might be argued, on the one hand, that there is no reason for ratepayers to bear the costs of such self-justification; that it is not of direct usefulness to them. On the other hand, it is extremely difficult to argue, especially now when public utilities are subjected to frequent public attack and criticism, that these are not, within limits, legitimate and indeed inescapable costs of doing business in today's conditions. It is unreasonable not to afford utility managements under attack an opportunity to explain and justify themselves. It might be argued, of course, that since such expenditures are on behalf of the companies rather than in the direct service of their ratepayers, they ought to be paid for by the shareholders. But if they *are* inescapable costs of doing business, and if, as is our policy, we allow shareholders returns only at the minimum level necessary to attract capital, then at least in principle if we were nominally to disallow these expenditures from rates, we would have to provide a correspondingly larger return on equity.

Our experience demonstrates that the time spent by our staff in ferreting through innumerable vouchers of institutional advertising is far out of proportion to the dollar amount of expenses found in that process to be unacceptable for rate purposes. For example, in the year 1975, *all* advertising costs spent by the seven largest privately owned electric, gas and steam utilities in New York State amounted to $3,370,000. Since the utilities received $5,280,264,000 in revenues for that year, the advertising costs equated to 6/100 of 1% of those revenues: six cents on *all* forms of advertising for every $100 in revenues received. It follows that since institutional advertising of a questionable nature is only a part—and typically a very small part—of total advertising, its impact on rates would be very

slight indeed. It is obvious that any benefits gained from close, individual examination of these insignificant costs must be outweighed by the costs of their examination.

It is for these reasons that we have decided to allow companies a very small pool of dollars in rates to cover both informational and the intermediate category of "other institutional" advertising. On the basis of past practice, this allowance will, in all probability, range between 1/10 and 1/25 of one percent of operating revenues, in inverse relationship to the size of the companies. It will be determined individually for each company, in its next or pending rate case,[1] on the basis of various other factors including size, geographical location, number of customers and costs of doing business in the area. Adoption of this modest lump sum advertising allowance approach will end the vexing and essentially arbitrary process our staff now engages in of reviewing all informational and other institutional advertising to decide whether specific expenses should be allowed or disallowed in setting utility rates.

This plan will obviously not solve all the problems we have described: we will still have to determine which advertisements are clearly political and/or self-serving, and specifically disallowed: and parties in rate cases would still be free to question the propriety of the lump sum allowance for the informational and other institutional advertising categories. On the other hand, it has the virtue of recognizing that some modest institutional expenditures, over and above those purely informational in nature, are an inescapable and legitimate cost of doing business, and get the Public Service Commission out of the business of an item-by-item content examination and evaluation of past advertisements—an activity in a sense redundant

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[1]In pending cases where the hearings have been completed, parties may present their views on a proper lump sum institutional advertising allowance on brief.

anyhow, in view of the fact that all we really do is set a reasonable level of rates for the future.

Our staff will maintain close and continuing scrutiny over the level of the lump sum advertising allowance for each company to assure that the amount provided is sufficient to cover only reasonable and necessary advertising costs consistent with this policy statement. We expect to review the policies set forth here periodically and to revise them when it seems desirable to reflect new or changed circumstances.

In the area of developing better public relations and avoiding obvious areas of customer dissatisfaction, utility managements are urged to give serious consideration to the clear labeling of the institutional advertising that will not be recorded as a cost of doing business for rate purposes. It is not in the interest of anyone to have institutional advertising exacerbate customer resentments at a time when large rate increases are made necessary by increases in various classes of costs beyond the control of utility management. Expenditures for institutional advertising *are* subject to management control and utility managements would be well advised, if the advertisement is either political or of a type not providing useful information to customers, to state in the advertisement itself: "The costs of this message are being borne by the company's stockholders and the expense will be excluded from consideration in any proceeding concerned with fixing the company's rates."

Appendix L

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

STATEMENT OF POLICY
ON ADVERTISING AND PROMOTIONAL
PRACTICES OF PUBLIC UTILITIES

ALFRED E. KAHN, Chairman, concurring in part and dissenting in part:

I am for the most part in agreement with the conclusions we reach in this decision and the supporting argument, having participated actively in their formulation. At the same time, my views about our proper role in regulating the advertising policies of utility companies are sufficiently distinctive from those of my fellow commissioners to make me want to set them forth in my own words and over my own signature.

I begin by saying, in different words, what our opinion says: namely, that the many hours that we, our staff, the regulated companies and various intervenors devote to utility company advertising policies, and to deciding what portion of such expenditures are properly recovered in rates, are by any reasonable test a waste of time and ratepayers' money. These efforts must surely have the lowest benefit/cost ratio of any in which we engage; and the time inescapably devoted to them by our staff and commissioners would almost certainly have a much larger pay-back to ratepayers if it could be devoted to other endeavors—such as the further scrutiny of management efficiency, the formulation of more efficient rate structures, more intensive pressures on the companies we regulate to engage in load management and to encourage conservation. The heated discussions about advertising policy are, in other words, a tempest in a teapot, considering, first, the very, very small number of dollars at stake, and, second, the essential fraudulence of our purporting to exclude from rates ex-

penditures for advertising that company managements will continue to feel it necessary to make: since we make every effort to set the allowable return on equity at the minimum cost of capital, and most of the companies we regulate are not earning even that, in principle putting any advertising expenditures "below the line" can only mean, if we are honest, increasing the allowed return on equity, in order to enable these companies to raise the capital they need on reasonable terms.

For these reasons, I am particularly enthusiastic about our decision to provide companies with a very, very modest lump-sum allowance for institutional advertising. It is a first step in the direction of sanity, offering the hope of cutting down on the endless hours our staff has to devote to scrutinizing individual advertisements, then deciding and litigating whether they are properly includable in test-year expenses for rate-making purposes.

At the same time, there are many things we do and must do that cannot be said to pay off on a pure dollar and cents basis. If it infuriates some consumers to see some of their dollars—even if for each of them it means only a penny a year—spent to extol the benefits of nuclear power, or to induce them to purchase additional electricity or gas, or to make greater use of the communications facilities provided them by franchised monopolists, we must confront the question of principle, of whether we should be condoning this kind of use of ratepayers' dollars, even if the confrontation costs ratepayers more dollars than the companies spend in these questionable ways.

If it comes to questions of principle, however, there are more principles at stake than the Commission seems willing to recognize in its decision today, and it is these that I take the occasion of this partial concurrence and partial dissent to spell out.

Appendix L

Promotional advertising by electric companies

It is only with the greatest reluctance and distaste that I join my colleagues in continuing our absolute prohibition of promotional expenditures by electric companies. While, as a non-lawyer, it has never been clear to me why the protections of the Fourteenth Amendment, which as a matter of historical fact was enacted to protect the rights of real, biological *people*, should necessarily have been extended to state-created artificial entities like corporations, I also believe in competition as a form of economic organization, wherever it is feasible. And for competition to be effective, some sales promotion is necessary. Even if that were not so as a general matter, it would in my judgment be inescapably so when there compete in the market two rivals, one of whom is free to advertise his wares and the other is—under our present policies—not.

The issue of whether electric companies should be permitted to advertise (observe that the question before us is not whether those expenditures should be recovered in rates, but one, rather, of our totally prohibiting such activities) arises almost exclusively in the context of summer-peaking electric companies wanting to be permitted to promote electric space heating, which is for them essentially an off-peak use of power, with their principal rivals, the distributors of *heating oil*, vociferously importuning the Public Service Commission and the Legislature to prevent them from doing so. An idea is not necessarily a bad one merely because it is propounded by a scoundrel, or—as in this case—a businessman who wants to be relieved of the burdens of competition. But it has always been a source of wonder to me how self-styled protectors of the consumer interest could have so readily allied themselves—to such a point that in some cases the distinction between them disappears entirely—with people who seek the assistance of government in suppressing competition.

There are considerations in this case, however, that induce me to go along with continued prohibition, however queasily.

1. The first is grounded in a combination of facts: first, that for apparently all of the summer-peaking electric companies in the state, marginal generating capacity off-peak as well as on is oil-fired, and promises to continue to be for several years; and that the use of such capacity to provide electricity for resistance heating, because of the fact that it takes something like three btu's of oil to generate the equivalent of one btu of electric energy, is simply far less efficient in energy terms and uses more oil in total than direct combustion of the oil for space heating purposes. (I must point out, however, that the three for one comparison grossly exaggerates the relative inefficiency of electric resistance heating, because it fails to take into account the energy costs of delivery of oil to the various points of consumption; the far less than 100% efficiency with which oil is typically burned in furnaces; the lesser injury to the environment from combustion of oil in electricity generation than, alternatively, in thousands of separate furnaces; and the promise of the heat pump of sharply increasing the efficiency of the use of electricity for heating. But electric space heating still seems to use more oil, typically; and it is a matter of utmost urgency to reduce the dependence of our economy on imported oil, which must supply the growing difference between what we are capable of producing at home and what we consume.)

On the other hand, I find myself in basic disagreement with the popular simplistic view that electric resistance space heating should simply be banned because it is "less energy efficient." I do not accept an exclusively energy standard of value. There are many pertinent costs and benefits besides the direct use of energy to be taken into account in making intelligent economic choices—the relative costs of labor, of capital installations of heating equipment (which also indirectly use energy), the

relative comfort and convenience of alternative methods of satisfying needs, the use of other scarce materials, and the damage to the environment. The only sensible common denominator for these various costs is the dollar: provided there are no major distortions in the price tags placed on these various elements of cost, it is the total dollar costs, not just the btu's that should be compared.

Moreover, I do not believe it is the proper function of a public utility regulator to tell people that they cannot have things for which they are willing to pay the price. It is our responsibility to see that prices reflect costs—all relevant social costs; it is our responsibility also to persuade and educate consumers to make intelligent choices. But I do not conceive it as our responsibility to tell people that they may not have something for whose total marginal social costs they are willing to pay: regulators are all too prone to substitute their judgments of what is good for people for the judgments of the people themselves.

For these reasons, it is only with the greatest reluctance that I go along with a policy that denies one competitor the right to advertise his wares, while leaving another free to do so, because we do not think customers should be encouraged to use electric resistance heating.

2. I do so, additionally, because the most promising mechanism for offsetting the relative inefficiency of converting fossil fuels into electricity is the heat pump; but installation of a heat pump means also installation of central air conditioning. To this extent, then, the promotion of off-peak electric space heating involves, in effect, the promotion also of on-peak summer air conditioning. Once again, my espousal of free consumer choice as a general principle would require me to regard such a development with equanimity—were it not for the fact that the price of electricity to most consumers in the state does not fully reflect the apparently much higher marginal social costs of on-peak consumption in summer peaking markets. Until each

consumer individually confronts a marginal cost-based, time-of-consumption rate, consumption on peak, with its large marginal use of oil-fired generation, is artificially subsidized.

If, then, the uncontrolled promotion of electric heating means the installation of heat pumps, which mean, in turn, more central air conditioning, the use of which is not charged its full marginal costs, the result is inefficient subsidization of consumption on peak, and higher rates for all consumers.

3. There are, of course, some electric companies in the state whose peaks fall in the winter rather than in the summer. It would seem that these might be permitted to promote, at least where there is a reasonable basis for believing the effect will be to stimulate sales off peak, improve their load factors, and therefore benefit all customers (provided the rates for the promoted service cover long-run incremental costs). But until we have ascertained in our generic electric rate proceeding (C.26806) whether the proper costing entity for marginal cost-based time-of-day rates is the individual company or the state system as a whole, such a relaxation of our ban opens up the possibility that, by permitting upstate, winter-peaking companies to promote summer air conditioning, we may in effect be encouraging a greater expansion of capacity for the State as a whole, which is summer peaking, than would otherwise be desirable. To put it another way, if the proper costing entity is the State rather than the individual company, the marginal costs of summer sales may be much higher than of winter sales even in winter-peaking markets. Until we have resolved these costing questions, there is a danger that permitting individual companies to promote sales off their own individual peaks will in effect involve uneconomic subsidization of those sales.

I do not regard flat prohibitions of promotion by public utility companies abhorrent as a matter of principle. Where a company enjoys something close to monopoly, conferred upon it by public franchise, it does not in my judgment have an unfettered right to

advertise. This is particularly so because merely disallowing such expenditures in setting rates, under the glib assumption that these costs will then be borne by stockholders rather than ratepayers, is something of a sham, for reasons I have already set forth.

Nuclear advertising

This last observation applies with particular force to the Commission's decision here to disallow the costs of advertisements publicizing company management views in favor of nuclear power. If electric company executives continue to feel that nuclear energy is in the best interest of their ratepayers, they are likely to continue to feel a responsibility for publicizing that fact. (And, for reasons we have already set forth in our Rochester Gas & Electric and Long Island Lighting Company decisions on this subject, decisions that the Commission majority reverses today, I would not wish them to refrain.) Since we set our allowance for return on equity at something close to the minimum cost of capital, and most companies in the state are in any event earning something short of that amount, any continuation of such "disallowed" expenditures by utility company managements would in principle require us to raise the return on equity allowance correspondingly. In these circumstances, telling companies to put certain expenditures "below the line" comes out either to telling them to stop making the expenditures entirely, or is essentially cosmetic—and a trifle insincere.

I would have been happy to go along with the resolution of this dilemma proposed by Commissioner Berlin to the RG&E and LILCO cases—namely that utility companies be required to provide equal support for the presentation of opposing viewpoints. A reading of the responses to our call for comments on this subject persuades me, however, that his proposed requirement would expose us to endless litigation; I reluctantly conclude that its administration would be simply impractical.

In these circumstances, my own preference would be to extend the modest lump-sum allowance we have decided to provide for *institutional* advertising to cover discussions of general public policy issues such as the desirability of nuclear power as well. The logic, I suggest, is the same: company managements are likely to feel a continued obligation to present their views on the merits of nuclear energy; they are likely to feel that this is in the interest of their ratepayers, possibly more than their stockholders (who hardly benefit when companies must sell stock below book value in order to finance these extremely costly plants); and I would be inclined to agree.

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

RE: STATEMENT OF POLICY ON ADVERTISING AND PROMOTIONAL PRACTICES OF PUBLIC UTILITIES

ANNE F. MEAD, Commissioner, dissenting in part:

I concur, with one exception, in the statement of policy issued this day on advertising and promotional practices of public utilities.

The one exception is the area of institutional advertising which is designed to create, enhance or sustain the corporate image of the utility or which indulges in self-congratulation or self-admiration of the utility or its accomplishments. In my opinion these advertisements should not be allowed as an operating expense in any rate schedule proceeding or for rate making purposes.

The institutional advertising which I describe above is not in my opinion a necessary or proper expense in providing utility service. At a time when utility rates are increasing beyond the ability of many to pay, any expense, no matter how small, that is not necessary or beneficial to the consumer should not be allowed for ratemaking purposes.

Appendix M

Notice of Proposed Policy Statement and Request for Comments on Advertising by Public Utilities and Electric Promotion Practices of the Public Service Commission of the State of New York, July 28, 1976

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

NOTICE OF PROPOSED POLICY STATEMENT
AND REQUEST FOR COMMENTS
ON ADVERTISING BY PUBLIC
UTILITIES AND ELECTRIC
PROMOTION PRACTICES

(Issued July 28, 1976)

Over the years, the Commission has developed a series of policies relating to advertising by public utility companies and other practices designed to stimulate increased sales of electricity. Some of these policies have in recent months been called into question, and the Commission is considering revising them. To this end, we solicit comments from interested parties to be submitted, in writing, to the Secretary of the Commission, Empire State Plaza, Albany, New York, 12223, not later than September 13, 1976.

The promotion of electricity sales

On December 6, 1973, at the height of the energy crisis precipitated by the exporting countries' boycott, the Commission flatly prohibited all sales promotional activities by electric companies. We are now considering relaxing that prohibition.

There is one aspect of the proposed relaxation on which we do *not* solicit comments at this time. That would be such promotion as would be the incidental consequence of efforts by electric utility companies to publicize, explain, and advise consumers on

how best to take advantage of time-of-consumption rates. As the companies introduce such rates, informational activities of this kind are clearly desirable, even where they might have the incidental effect of increasing the aggregate sales of electricity.

The proposition on which we do solicit reactions is that we relax our absolute prohibition of sales promotional activities by electric companies generally, apart from those that are merely ancillary to the introduction of time-of-consumption rates. (The distinction will in important instances be difficult to draw: since the downstate companies are summer-peaking, one purpose or result of rates varying by the season of the year could be to promote the use of electric heating, and, largely because of the very heavy use of electricity involved, this is the most controversial promotion of all.)

On the side of continuing the flat prohibition are such considerations as the following:

1. Electric companies are franchised monopolists, and no public interest or need is served by permitting monopolists to promote sales.

2. It is especially undesirable to cover the costs of such promotional activities in rates, thereby forcing captive customers to pay for activities designed to influence their consumption habits (in contrast with merely providing them with information).

3. Turning specifically to the promotion of electric resistance space and water heating: it conflicts with the national interest in energy conservation to promote additional utilization of electricity, which by its very nature uses approximately 3 Btu's of source energy to deliver 1 usable Btu. Electric resistance heating is therefore inherently inefficient in its use of primary energy, compared with the direct burning of gas or oil in furnaces, even after making allowance for the greater efficiency-in-use of the electricity than those fuels.

4. The equipment for electric resistance heating is considerably less costly than for gas or oil. Since builders typically have a strong incentive to hold down the first costs of construction, they may already have a distorted incentive to install the former in preference to the latter, even though the result may be to impose markedly higher annual heating costs thereafter on the purchasers, who are frequently, perhaps typically, not in a position to weigh the higher future running costs against the lower initial purchase price in making their purchase decisions. In these circumstances, it is particularly undesirable further to encourage irrational purchase decisions by permitting the promotion of electric heating.

5. The heat pump promises to mitigate some of these efficiency disadvantages of electric resistance heating; however, the effects of its widespread introduction on utility peak load and load factors are uncertain.

Arguing on the side of a relaxation are the following considerations:

1. In major uses, electricity competes with oil and gas, and while we proscribe the promotion of gas, the distribution of heating oils is totally outside our control, and advertising by those distributors freely permitted: in these circumstances, it is not only unfair but produces distorted results for consumers to be freely exposed to advertising messages by one set of competitors, while the other is totally prohibited from communicating with them.

2. Electricity and electrical appliances compete with all other goods and services for the consumer's limited dollars. It is inconsistent with a consumer-sovereign and free enterprise economy for certain goods and services to be denied the right to compete for those dollars while other competitors—many of which may be promoting even less energy-conserving consumption—remain unrestricted. It is the function of a

regulatory Commission in such an economy to see to it that prices accurately reflect cost—not to go beyond that and dictate to consumers and businesses, directly or indirectly, how they should allocate their expenditures. Consumers are, to be sure, entitled to protection against misleading advertising, and the foregoing considerations would probably not absolve the Commission from responsibility to ensure that the promotional information supplied by franchised public utilities is in fact not misleading. The proper solution to the possible problem, described earlier, arising from the possibility that builders may have a distorted incentive to install electric resistance heating, because of its lower first cost, is to provide purchasers with reliable information about the expected life cycle costs of buildings equipped with different heating systems.

3. The function of the Commission is to see to it that the prices of the services it regulates reflect society's costs in supplying them, and that consumers are well-informed—not to tell consumers what advertising messages they may and may not hear.

4. Gas is in short supply, and in most territories unavailable for use in new construction, so that for most uses the only available alternative to electricity for space heating is oil. Prohibition of electricity promotion thus contributes to giving oil a monopoly in that market (whether this creates a danger of monopolistic exploitation depends on the effectiveness of competition in the oil industry.)

5. While promotion of heating with electricity generated from oil (because of its less efficient use of the primary energy source) runs counter to our national policy of reducing our dependence upon imported oil, the increased use of electricity generated from nuclear fuel and coal would make a positive contribution to that goal.

6. Electric space heating is environmentally preferable to the direct combustion of oil: it is less polluting to burn fuels in

central electricity generating stations than in thousands of individual furnaces.

Institutional and informational advertising

The Commission does not flatly prohibit advertising of these kinds, nor does it contemplate doing so. (Institutional advertising is difficult to define except as all advertising that is not fairly clearly intended to promote sales. It usually embraces informational advertising, but in some contexts a distinction between the two is useful.) The issue on which we solicit reactions has to do with the extent to which advertising of these kinds may properly be recovered in rates, as legitimate expenses of doing business and serving consumers.

We do not solicit comments on two kinds of advertising our policy with respect to which is of long standing and essentially noncontroversial:

1. Advertising that provides information of direct use to consumers is a legitimate expense of doing business, and properly recovered in rates. This would include, for example, appeals for conservation; instructions in the proper use of equipment; information about new rates, billing practices, inspection and meter-reading; reports on matters of direct interest to the public concerning the utility company's service—service difficulties and progress in overcoming them.

2. At the other extreme, political advertising in support of or opposed to specific governmental actions—proposed legislation or referenda—may not properly be covered by rates, on the ground that it is either serving the interest or promulgating the particular opinions of management or shareholders, which may or may not coincide with those of ratepayers. Ratepayers should clearly not be expected to pay to have a company's political views expressed. All clearly political advertising is therefore recorded in a nonoperating expense account, below the line, and ex-

penditures recorded in this account routinely excluded from the ratemaking process.

It is in the wide area between these two extremes that we seek guidance—the institutional advertising that is not clearly useful to utility customers, on the one hand, or clearly directed toward influencing specific legislation, on the other.

There is advertising, for example, in which a company defends, justifies, or even merely explains and describes its activities. It might be argued, on the one hand, that there is no reason for ratepayers to bear the costs of such self-justification; that it is not of direct usefulness to them. On the other hand, it is extremely difficult to argue, especially these days when public utilities are subjected to frequently unjustified public attack and criticism, that these are not, within limits, legitimate and indeed inescapable costs of doing business in today's conditions. It seems unreasonable not to afford utility managements under attack an opportunity to explain and justify themselves. It might be argued, of course, that since such expenditures are on behalf of the companies rather than in the direct service of their ratepayers, they ought to be paid for by the shareholders. But if they *are* inescapable costs of doing business, and if, as in our policy, we allow shareholders returns only at the minimum level necessary to attract capital, then at least in principle if we were nominally to disallow these expenditures from rates, we would have to provide a correspondingly larger return on equity. It can be argued, in short, that "disallowances" of such expenditures from rates are nominal only, if not disingenuous.

One of the most controversial kinds of expenditure in this area is advertising that directly or indirectly promotes the merits of nuclear power. Argument over whether the cost of advertising of this kind should be allowed in rates has assumed major proportion. It might arguably be characterized either as informative, and permissible, or political, and to be disallowed.

Appendix M

The Commission has come to the view that exclusion of the costs of such advertising from rates on the traditional grounds that it can be fairly characterized as "political" is no longer adequate to protect the interest of the public generally and of ratepayers specifically. The public issues surrounding nuclear power generation are very complicated, and the public is being beset by discussions on matters in which it is of great importance that all points of view be presented. We feel there is a definite ratepayer interest, therefore, in a free and full public discussion of this matter, and that utility companies do have a contribution to make to that discussion, regardless of whether we agree or disagree with the content of their messages in specific instances: after all, the Commission's assessments today of the substantive merits of controversies like these could well prove to be wrong tomorrow. Accordingly, a majority of us has in two recent cases considered advertising that presented the case in favor of nuclear generation to be informational in nature and properly included as a cost in computing rates in modest quantities. Others of us have felt, however, that such an allowance in rates should be permitted only on condition that the company use its funds to provide something like "equal time" to reasonable statements of legitimate opposition to this position. We will appreciate reactions to this latter alternative.

In addition to soliciting advice on these complicated matters, we solicit reactions to an alternative possible approach to this subject. The alternative would retain our present scrutiny of advertising with a view to continuing our traditional policy, described above, with respect to advertising that can clearly be labeled as informational on the one hand and political on the other—with routine allowance of the former and disallowance of the latter; but would abandon the necessity for detailed scrutiny and determination of what to do with advertising that falls in the broad and relatively amorphous middle area.

Appendix M

For that broad middle area of informational and institutional advertising, the suggestion is that we might routinely allow the companies in rates some very small pool of dollars, based roughly on past practices, probably on some sort of sliding scale—say, ranging between 1/10 and 1/25 of one percent in sales, possibly in inverse relationship to the size of the companies—and suspend the vexing and essentially arbitrary process of deciding with respect to each advertisement whether it should be allowed or disallowed.

This proposal would obviously not solve all the problems we have described: we would still have to determine which advertisements are clearly political and/or self-serving, and specifically disallowed, and which clearly informational and of direct use to ratepayers, and therefore explicitly allowed; and parties in rate cases would still be free to question the propriety of the lump-sum allowance for advertising in the broad intermediate category. On the other hand, it would have the virtue of recognizing that some, modest institutional expenditures are an inescapable and legitimate cost of doing business, and get the Public Service Commission out of the business of any item-by-item content examination and evaluation of past advertisements—an activity in a sense redundant anyhow, in view of the fact that all we really do is set a reasonable level of rates for the future.

If any interested parties have alternative suggestions we would be pleased to receive them. In proposing alternatives, we ask respondents to bear in mind the desirability of reducing the considerable amount of staff and Commission time now consumed in the detailed scrutiny of advertising, and in hair-splitting determinations where the amount of dollars involved is close to minimal.

By the Commission,

SAMUEL R. MADISON
Secretary

Appendix N
EXCERPTS FROM STENOGRAPHER'S MINUTES OF TESTIMONY

EXCERPTS FROM STENOGRAPHER'S MINUTES OF TESTIMONY

Appendix N-1
Staff Witness Rosenstrauch

Advertising [1738]

Q. Did your audit include a review of the company's advertising?

A. Yes, it did.

During the test year, RG&E spent $616,636 on electric advertising. The book account distribution was as follows:

911	Informational	$ 543,952
917	Promotional	21,140
930.1	Institutional	51,544
		$ 616,636

Our audit disclosed that all of the amounts charged to Promotional Advertising were related to "Area Development" which, under the Uniform System of Accounts, is properly includable in a sub-account of Account 917 - Promotional Advertising. It is my conclusion that the test year advertising expenses include no item which is now specifically prohibited by the Commission's February 28, 1977 policy statement.

Q. Will you please explain your adjustment #8 to Advertising?

A. The policy statement also stated that between 1/10 and 1/25 of one percent of Operating Revenues would be aligned for Informational and "Other Institutional" Advertising, the exact amount to be determined on the basis of various criteria such as size of the company

and other characteristics. We are proposing that the minimum allowance of 1/25 of one per cent of electric operating revenues, or .0004, be allowed. The minimum amount is proposed here, not on the basis of an analysis of the specific characteristics and circumstances of RG&E, but because we feel it is the company's burden to justify any amount above the minimum. Based on the total test year Electric Operating Revenues of $188.8 million, one twenty-fifth of one percent would be $75,500. My adjustment, then would be the difference between the amount booked for Informational and Institutional Advertising ($595,500) and the allowed amount of $75,500, which equates to $520,000.

Q. What is the relationship of RG&E's Electric test year informational and "Other Institutional" Advertising to Operating Revenues?

A. Approximately 0.32%. I computed this by dividing $595,000 by $188.8 million.

Q. What would be the test year adjustment if the maximum of 1/10 of one percent of Operating Revenues were ultimately determined to be the allowable amount of Advertising?

A. It would be $406,750, as compared to $520,000 at 1/25 of one percent.

Q. Will you please continue your explanation of each adjustment in Column 2?

A. Adjustment #9 increases the depreciation expense by $206,565 as per the testimony of Mr. Van Vranken.

Q. Will you please explain adjustment #10 to Taxes Other Than Income Taxes—Payroll Taxes?

A. This adjustment for $47,514 is in two parts, (a) and (b). Part (a) reduces the company's social security tax adjustment by $20,668 for the amount due to the 1978 wage increase which we have proposed to exclude.

Part (b) reduces the company's adjustment by $26,846 due to staff's method of allocation of additional wages over $16,500 per employee.

In summary, the company's method of computing social security taxes includes overtime dollars in excess of the $16,500 base whereas staff's method does not.

When the 1978 wage increase becomes known, we propose that along with the wages, the additional social security tax thereon be computed by the company utilizing the same methodology as staff's and that rates be adjusted to recover this additional amount.

Q. Will you please explain adjustment #11 to Taxes Other Than Income Taxes—Revenue Taxes?

• • •

ROSENSTRAUCH [1756]

just a few months after the rate adjustment allowed in this case, whatever it may be, goes into effect to be more desirable?

A. Well, I believe the way the question was stated, "within a few months," I think—well, as a matter of policy, I think it probably should be up to the Commission to determine just how many a few should encompass, but I don't really have any objection to it.

Q. Well, have you considered, in certain respects, an increase late in 1977 with an allowance for the 1978 wages and taxes would have some merit over two increases within a very short interval?

A. It is possible.

Q. Now, your testimony as to Adjustment 3 to the Electric Department, applies similar assessment as No. 4 in Mr. Knapp's Exhibit?

A. Yes, it does.

Q. I am turning to the amount of advertising. You have made two adjustments for amortizing, haven't you?

A. Yes, I have.

Q. One adjustment is Adjustment No. 5 in the amount

ROSENSTRAUCH [1757]

of $58,637 which is included in the total of $594,652.

Now, that is derived by multiplying $488,645.00 times 12 percent, isn't it?

A. Yes, it is.

Q. Now, this is an adjustment to the Company's escalation adjustment for Schedule G, Page 2 of Exhibit 11-A, isn't it?

A. I think you mean No. 10-A, the Electric.

Q. I guess.

A. Yes, it is.

Q. And the second adjustment is Adjustment No. 8, which is the reduction of $520,000 to allow the Company 1/25th or .0004 percent of gross revenues is that not so?

A. Yes, that is so.

Q. But in that calculation, according to your testimony on Page 8, that calculation was based on test year book revenues of $188.8 million; is that right?

A. Yes.

Q. Now, assuming the propriety of the adjustment for the moment, should it at least be based on

ROSENSTRAUCH [1758]

the pro forma revenues of approximately $193,700,000 as shown in Column 3 after Mr. Van Vranken's adjustments have been made?

A. Technically, yes, it should. However, it was in this particular case, in any company we—the revenues are going to have some fluctuation because of the—because of the fuel adjustment provisions and I had really intended that it be rounded to that effect; that is, I based the—I based it on the book revenue amount but yes, it, theoretically it should be based on all Staff adjustments.

Q. Well, that would be technically in the Company's favor, would it not?

A. Yes, it would.

Q. You say on Page 8 that you use the minimum, that is, 1/25th of one per cent not on the basis of the specific characteristics or circumstances of RG&E, but you just used that minimum arbitrarily, did you not?

A. That is correct.

Q. Now, the Commission's policy statement, of course, speaks for itself, but do I understand your testi-

ROSENSTRAUCH [1759]

mony on Lines 6 and 7 of Page 8 to suggest that the door is left open for the Company, perhaps on rebuttal, to justify any amount above the minimum?

A. Yes. That was my intention.

Q. So we start with the arbitrary minimum and say, "It is up to the Company to come forward and justify." Is there anything

in the Commission's Order related to the policy statement that would require that?

A. Just from my memory, I believe there is. I—I believe you said previously, though, that the Commission policy statement speaks for itself?

Q. Yes, and I would include the Commission's Order would also speak for itself.

A. Yes. In the Commission's policy statement, if I could reference that to Page 13 about five, one, two, three—five lines from the bottom of the page it says, "It will be determined individually for each company in its next or pending rate case."

Q. Okay. And what you are saying is, from your point of view, let's start at the bottom and let

ROSENSTRAUCH [1760]

the Company work—work on it?

A. That is exactly what I am saying.

Q. All right. Is it your testimony with respect to Adjustment No. 5 also that it would apply as to the advertising adjustments 9 and 10 in Mr. Knapp's testimony and the exhibits in the gas case?

A. Yes, it does.

Q. I am only doing this in the interest of expedition?

A. Yes.

Q. Now, I would like to discuss the subject of Federal Income Taxes, and in that Table where you will be discussing Investment Tax Credit Inter-period Tax Allocation and Effective Tax Break. Would you look at Page 1 of your Exhibit? In Column

Appendix N-1

No. 1 the current provision for Federal Income Taxes shows a negative amount of $3,351,800; is that right?

A. That is right.

Q. And a Staff Adjustment of $1,496,500 results in the column 3 figure, which is still a negative amount of $1,855,300; is that right?

A. That is right.

• • •

Appendix N-2
INTERVENOR WITNESS PLITT

Plitt [1815]

Advertising

The Public Service Commission issued February 23, 1977 its statement of policy on advertising and promotional practices of public utilities. The Commission held that a small lump sum amount of money could be allocated to a utility for informational and other institutional advertising. It cited as legitimate costs appeals for the conservation of gas or electricity, notification about new rates and the like.

RG&E's advertising expenses in the most recent past have been largely spent on weekly full page and smaller ads in local newspapers, and nightly television advertising. The emphasis of most of this advertising has been self-serving as demonstrated by attachments A-E. Attachments A-C are ads declaring RG&E is Rochester's #1 taxpayer. These ads ran continuously for weeks in local publications. They serve no discernable purpose. It is the public's money paying both that tax bill and for those ads. Attachment D represents a sample of a weekly RG&E advertisement representing a full page of "consumer news." How is it relevant to the public to have its money spent on advertisments that declare the degrees days measure or when the sweet Adelines will present their production of "Somethin Showy?" Attachment E is a full page ad seeking to justify its nuclear power plant as being safe. It also implies in a sexist way that only trained men are at RG&E's Ginna plant. According to Mr. Sweetland, RG&E seems to have no set goals for its conservation effort. RG&E's plan to provide customers with a furnace attachment to conserve gas is as declared in the March 25, 1977 Times-

Union report an attempt of RG&E's to "produce more gas which the utility hopes to sell to new customers." This is reflective of RG&E's lack of real commitment to conservation. Certainly, no advertisement stating otherwise can change RG&E's desire to sell more gas to more customers. This is also documented in the events of December 1976. See attachment F.

In view of RG&E's misuse of its institutional and informational advertising and in view of its lack of fundamental commitment to conservation of resources, RG&E should be forced to justify any advertisement in the future that is not directed specifically to meaningful conservation or to required billing or rate information to be shared with the public. As a result, it should be allowed only $100,000 for this purpose and no other advertisement expenditures should be paid by the public.

Productivity

RG&E has indicated that it has taken particular action to reduce its operating costs by $127,600. Such a minor reduction in operating costs of over $400,000,000 can not be acceptable for a utility responsible for minimizing costs and operating at maximum efficiency. Private corporations have taken far more aggressive action. The Public Service Commission must require a similar, if not greater aggressive, determined effort on the part of RG&E to reduce its operating costs by at least an additional $1,000,000 which is still less than a quarter of one per cent of its expenditures.

The following actions are recommended:

* * *

Appendix N-3
INTERVENOR WITNESS SLAUGHTER

Slaughter [1831]

Customer Service and
Sales Promotion Expense (650,000)

This adjustment removes all sales promotion expense and reduces out of pocket informational advertising expense to $50,000 with appropriate further reductions in internal customer service expense. Reasons for total elimination of energy industry propaganda is contained in other Genesee testimony.

Administrative & General Expense (1,000,000)

This adjustment reduces salaries, outside services, and miscellaneous general expense by 15% ($776,000). The additional $224,000 represents a 2.2% reduction in the remaining accounts in this category. Even these adjustments would leave RG&E as the highest cost NYS utility on a per customer basis. Further improvement must continue to be demanded by the Commission.

EXHIBIT 11A Gas Department—ADJUSTMENTS

Customer Accounts ($233,000)

This is one third of a proposed three year reduction of $700,000 in incollectables which would achieve an annual uncollectable balance of about $250,000 a figure closer to the 1973 balance of $207,000.

Slaughter [1832]

Customer Service & Sales Promotion Expense ($100,000)

This adjustment reduces out of pocket informational advertising to $50,000 and assumes other internal expense reductions.

Appendix N-3

Administrative & General Expense ($550,000)

Reduces salaries, outside services and miscellaneous general expense by 15% ($432,000). Balance of reduction represents 3% decrease in remaining administrative & general accounts.

PSC POLICY ON DISCLOSURE OF INFORMATION

In the RG&E rate case prior to this one the PSC examiner ruled with the company's hired energy industry lawyers against disclosure of EEO data and possible effects of government suits in that area on the grounds that the cost impact of these matters would not be allowed to show as an "expense" in the rate of return calculation.

In the present case, the examiners ruled with the company's lawyers over our objection, that the company did not have to be examined on expense incurred in conducting a campaign opposing the referendum for municipal takeover of power distribution by the Village of Hilton, N.Y. The examiner used the same rationale.

Slaughter [1833]

We are concerned that attempts will be made in the future to prevent disclosure of propaganda expense which under the recent PSC ruling must be borne by stockholders and not included as expense in the rate of return formula.

It is deceitful on the part of the PSC to pretend that it is protecting rate payers by transferring items from the expense category of the rate making formula to the "stockholders". The stockholders are represented in the formula by the rate of return on rate base factor. This factor is derived from the rate of return on owners equity. Companies hire expert witnesses to establish this value and it is a major part of every rate proceeding. All expense is ultimately reflected in owner's equity. The present

formula allows all revenue requirements to satisfy owners requirements and to be derived from the pockets of rate payers. If practices are deemed to be contrary to the interests of the rate payer or the common welfare, the only way for the rate payer to be protected is to have the practice disallowed entirely.

The private utilities of New York State are regulated, protected, private monopolies. It is even questionable whether

or not the stockholders have corporate control. Investors of debt may be the true effective equity in the industry. Under these circumstances the monopolist has no case when he invokes principles which are the legitimate property of firms in the free enterprise, competitive market economy. In this industry, prohibition of expense contrary to the public interest is surely justified and the rate payers have a right to expect such decisions from the commission.

Nevertheless, as long as such expenditures are allowed, any entity that pretends to represent the consumer interest, such as the PSC, has an *obligation* to require the disclosure of *any* expense or *any* policy effecting expense since full recourse to the consumer is allowed for *all* revenue requirements, albeit by somewhat obscure paths.

The company argues that advertising expense is so small a proportion of total expense as to be immaterial and unworthy of the concern for the PSC. We applaud the fact that the examiner and PSC counsel in the present case resisted this argument. Any company whose size and power is so great that its pervasive use of the media is immaterial is a power to be feared. Comparable access to media is impossibly expensive to those who have not obtained centralized economic

control in the community. It was never the intent of the American system to allow such power and influence to those who have been granted rights to exploit natural monopolies.

CONSERVATION, ENERGY OPTIONS & GROWTH

The company submitted testimony on conservation in response to a PSC directive requiring them to implement efforts and plans to conserve energy growth particularly "consumption which results in the need for additional production facilities". The company's efforts in this area have been so shallow that the "plans" have not even been considered in marketing plans or growth projections. Because of this we have produced four growth scenarios in order to place RG&E's conception of future growth in some perspective. The scenarios are contained in Exhibits 1S, 2S and 3S. They are:

"The Rochester Gas & Electric (RG&E) Scenario"

"The Combination of All Technologies (COAT) Scenario" developed by ERDA

"The Conservation (CON) Scenario"

"The Cogeneration (COG) Scenario".

Reference for the ERDA and Cogeneration assumptions is the article in *The Bulletin of the Atomic Scientists*,

* * *

Appendix N-4
ROCHESTER WITNESS SILVESTRONE

Silvestrone [2128]

Q. Would you please state your name and address?

A. Mario Silvestone, I reside at 502 Lake Road, Webster, New York 14580.

Q. Mr. Silvestrone, what is your position with RG&E?

A. I am a vice president.

Q. How long have you held that position?

A. Since October, 1975.

Q. What are your duties and responsibilities?

A. I am responsible for the activities of several areas of the Company, including Corporate Communications. In addition to Corporate Communications, they include Marketing, Customer Relations, Purchasing and our outlying Districts.

Q. How long have you been with the Company?

A. Twenty-seven (27) years.

Q. Will you briefly outline your experience and qualifications?

A. I am an engineering graduate of Rensselaer Polytechnic Institute and hold an MBA degree from the University of Rochester. I am a Registered Professional Engineer in New York State. I was employed by the Company as a Marketing Engineer and subsequently held the positions of Manager, Commercial and Industrial Marketing and General Marketing Manager, and now my present position. The Marketing Communications Department reported to me

Appendix N-4

Silvestrone [2129]

from October 1969 until October 1974 when it was merged into the Corporate Communications Department. The Corporate Communications Department has reported to me since it was formed in October 1974.

Q. For what purpose are you presenting rebuttal testimony in these proceedings?

A. Staff witness Rosenstrauch has proposed that the Company's electric department advertising expenses be reduced from $595,500 to an amount of $75,500, an adjustment of $520,000, and that the Company's gas department advertising expenses be reduced from $162,324 to $40,411, an adjustment of $121,913. Mr. Rosenstrauch has based his adjustment on the Statement of Policy on Advertising and Promotional Practices of Public Utilities which was issued by the Commission on February 25, 1977. In fact, the adjustment proposed by Mr. Rosenstrauch is based upon the lower end of the range for a "small pool of dollars" which the Commission indicated it would probably allow; however, the Commission indicated that larger companies could be expected to get the smaller percentage and the smaller companies could be expected to be allowed the larger percentage in the range. Mr. Rosenstrauch indicates that, using 1/10th of one percent, his adjustments would be $406,750 and

SILVESTRONE [2130]

and $61,297, respectively. Mr. Rosenstrauch states that his proposed adjustments are not being made "on the basis of an analysis of the specific characteristics and circumstances of RG&E, but because we feel it is the Company's burden to justify any amount above the minimum".

My testimony is for the purpose of showing that the Company's test year advertising expenses are proper, and that the adjustments proposed by Staff in this area are inappropriate.

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Q. On what basis do you believe that Staff's proposed adjustments to advertising expenses are inappropriate?

A. In the first place, Staff has not presented any evidence that the Company is spending excessive amounts on advertising. Staff witness Rosenstrauch has acknowledged that "the test year advertising expenses include no item which is now specifically prohibited by the Commission's February 28, 1977 policy statement". And no particular advertising has been pointed out as unnecessary or unwarranted. Instead, Staff has merely adopted the lower end of the range which the Commission has abstractly indicated will be found proper "in all probability". In the second place, that range is, itself, wholly inadequate for the Company.

SILVESTRONE [2131]

It clearly would not enable the Company to undertake the advertising which, in the judgment of management, the Company must undertake.

Q. Have you any facts with which to show that the possible range suggested by the Commission would be inadequate for Rochester Gas and Electric Corporation?

A. Yes, I believe I have.

As Mr. Rosenstrauch has testified, the possible range suggested in the Commission's Policy Statement would allow the Company from $115,911 to $289,777 for informational and "other institutional" advertising by the electric and gas departments combined. A review of the Company's actual advertising expenses in 1976 will demonstrate the inadequacy of either such amount.

First, in the overall area of Conservation, the Company spent $258,524 in 1976. These dollars represent advertisements, displays, booklets, demonstrations and bill inserts. All of this effort was aimed, in various ways, at urging our customers to

use less energy and telling them how to do so. It covers promotion of insulation in all forms; it advises on the selection, installation, and manner of operation of appliances which will use the least energy; and it stresses the general emphasis on "turning it off" or

SILVESTRONE [2132]

"turning it down". Let me give some examples.

In ads captioned "How To Cut Fuel Consumption by as Much as 15%", we have urged the installation of storm windows and doors. In an ad captioned "The Cost of Living is Going Through the Roof" we recommended application of proper insulation materials in walls and attics. We've told customers in another ad that "If You're Underinsulated, You're Overspending on Fuel".

In the promotion of energy conservation in regard to air conditioning we have said, "Some People Are Too Cool", and recommended that they not overtax their air conditioning system in bringing the temperature down too far; and we have also told them to "Take A Little Heat".

For electric conservation in general we ran the ad "Don't Waste Electricity, the Meter's Running". In more specific areas of electric energy conservation we asked people to "Start Your Own TV Program" and to turn off the set when no one is watching. In the ad "Fulfill", we urged our customers to conserve hot water and energy by washing and drying larger loads of clothes instead of several smaller bundles. For electric lights we urged customers to "Join the Light Brigade" and to save money and conserve energy by shutting off lights

SILVESTRONE [2133]

they don't need. In a specific approach for new homemakers, we captioned one ad as, "First Aid for Newlyweds" and described conservation measures in cooking and household operation.

Appendix N-4

Many of our ads announce the availability of our booklets on conservation such as: "If You're Underinsulated"; "Be a Watt-Watcher"; "Energy Efficiency in Room Air Conditioners"; "8 Ways to Save"; "Cool It Wisely"; "63 Ways to Save". More than 170,000 of these conservation booklets were disseminated in 1976 at consumer request in response to these ads.

Any effective communication about conservation is contingent on proper dissemination. Thus the Company has devoted a relatively large portion of its advertising budget to its conservation program.

Second, in the area of Safety, the Company spent $108,788 in 1976. These dollars represent advertisements, bill inserts, booklets and films.

The personal safety of our customers, their families, or anyone in the community, is of vital concern to the Company. Our informational program for safety with regard to gas and electric is designed to cover a wide variety of potentially dangerous situations that have accounted for deaths and injuries each year in this country.

SILVESTRONE [2134]

In addition to safety in the home and at work, the Company also stresses safety outside with respect to transmission towers, electric substations, secondary lines, and gas leaks.

Ads on safety were developed with captions such as: "Wet Feet Can Be The Death of You"; "If You Smell Gas, Call RG&E"; "What You Don't Know About a Ground Fault Interrupter Could Kill You"; "Fly a Kite Right". Radio and TV commercial announcements warn of hazards in entering substations, climbing poles and towers, and detecting gas odors. Booklets were advertised and made available to the public. The titles of some included: "Shock Stopper"; "What Everyone Should Know

About Electric Safety"; and, "Don't Be in the Dark About Electric Safety".

As part of the safety program, a number of films and associated booklets are made available through the Company for loan to schools and groups. In 1976, the Company was instrumental in producing a safety film that deals specifically with electric safety outside. The Company has plans for wide dissemination of this film in conjunction with videotaped portions of an interview with a youth who was involved in a tragic accident on a transmission tower recently.

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This portion of our advertising expenditures also includes our promotion of our "One-call Program" by which we urge people, especially contractors, to call us before they excavate so that we and the other local utilities can locate our underground facilities for them.

Again, we believe that safety is a very important matter and for that reason we devote a substantial portion of our advertising budget to it.

Third, in the area of Information—Service, the Company spent $87,276 in 1976. These dollars represent advertisements, bill inserts, booklets, and brochures. By the category of "Information—Service" I have reference, in general, to information which an individual customer requires on how to obtain and maintain his or her service, and how to utilize it properly.

This category includes subjects that the Commission requires the Company to address to customers. Included are the printing costs of, and ads for, the Service Information Folder (two languages), ads and posters for phone numbers not listed in the telephone directory, procedures in dealing with a low-voltage situation, information on gas conversion (two languages), and information on complaint procedures.

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The Company has also produced a booklet entitled,

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"How To Avoid Unnecessary Service Calls", and we advertise its availability. The purpose of this booklet is to help save money for customers by advising them to first check to see if the appliance is plugged in, or if a fuse is blown, or circuit breaker tripped, before they make the assumption that the appliance is in need of repair or before they request a service call. Similarly, this category includes the cost of bill inserts on budget billing, our new bill format, third party disconnect notices and questions commonly asked about our bills.

Also included in this category of advertising expense are the publicizing of our office hours, especially for holiday periods, the publicizing of how to identify our meter readers, the explanation of our red tag program, and information on how to choose a contractor.

Fourth, in the area of Educational/Technical, the Company spent $6,154 in 1976. These dollars were spent primarily on the production of technical specifications for heating contractors on electric heating, and on advertisements publicizing the availability of booklets giving data on heating, lighting, and air conditioning.

SILVESTRONE [2137]

Fifth, in the area of Energy Costs, the Company spent $67;082 in 1976. These dollars represent, primarily, advertisements and bill inserts. I should point out, however, that, as shown on Exhibits 10A and 11A, the Company has adjusted out, for rate making purposes, approximately $23,000 included in this category through its "Case 27108 (and 27109) information brochure" adjustment. Thus the balance of this category of expenditures is approximately $44,082. On the other hand, the Company believes that even this $23,000 would have been an

allowable expense for rate making purposes absent its commitment not to include them in this instance.

Many of the speakers who made statements at the public hearing held on January 18, 1977 in these proceedings clearly demonstrate the need for the Company to remind its customers of, or explain to them, the reasons why our rates have been increasing and to try to put the increase in energy costs in perspective. It often appears evident to the Company that many of its customers, although acutely aware of the impact of inflation upon themselves and those around them, fail to appreciate the impact of inflation, as well as other factors upon Rochester Gas and Electric Corporation.

SILVESTRONE [2138]

Television and radio time, as well as newspaper ads, are used to communicate the message that the cost of energy from Rochester Gas and Electric Corporation is largely affected by the inflation that impacts on every endeavor in our society. One ad, for example, is captioned, "Our Utility Poles Are Over Twice As High As They Used To Be" and explains how dramatically costs for materials in the power business have risen in just a few years. Similarly, we have run ads designed to make our customers aware of the impact of taxes and environmental requirements upon our costs and, in consequence, their rates. Attachments A, B and C to Exhibit 45 are an example of one such advertisement. Further, we have attempted in advertisements and bill inserts, to make our customers aware of what has happened to electric and gas costs relative to other costs which they bear.

The entire area of utility rates is a sensitive, complicated, and often misunderstood issue. We believe that it is important to our customers that we attempt to explain it to them.

Sixth, in the area of Community, the Company spent $71,544 in 1976. These dollars represent window displays, advertisements, and bill inserts. This amount includes

SILVESTRONE [2139]

the $21,140 identified by Mr. Rosenstrauch for Area Development.

Through expenditures in this category the Company attempts to meet part of its responsibilities as a member of the community by assistance to non-profit and charitable organizations. Included in these efforts is the publicizing of their activities and their fund drives. An example of this activity is shown on Attachment D to Exhibit 45.

Rochester Gas and Electric Corporation considers itself to be a part of the community in which it renders service. It is a characteristic of our service area that businesses as well as individuals share in supporting and assisting community and charitable organizations. As such we believe these expenses are clearly a proper cost of doing business.

Seventh, and finally, in the area in Information—Company, the Company spent $180,491 in 1976. These dollars reflect advertisements, bill inserts, brochures and booklets. By the category "Information—Company" I mean information about the Company, what it is doing and why, and what its problems are. It is likely that the Commission would consider much of this category to be "institutional advertising"; however, I have used a

SILVESTRONE [2140]

different label to emphasize my belief that with these dollars we are communicating information which our customers need to receive.

Appendix N-4

Included in this category have been such messages as information on alternate sources of energy, information on how our membership in the New York Power Pool benefits our customers, information on what the Company is doing to protect the environment, information on the availability of, and on what is available at, our Brookwood Science Center, information on the need for new power plants, information on why the Company advertises, information on our need to obtain large amounts of capital, and information regarding some of the research and development projects in which the Company is engaged.

This category also includes expenditures for brochures and booklets designed to provide a layman with a general understanding, in basic terms, of the overall utility business. Also included in this category are expenditures on advertisements intended to both explain to, and reassure, our customers about our operations at the Ginna nuclear plant; on this latter item I will have a further comment later in my testimony.

Q. What conclusion do you draw from the foregoing?

A. I conclude quite simply that the amount of money which

SILVESTRONE [2141]

the Company would be allowed for advertising under the possible range suggested in the Commission's Policy Statement would be wholly inadequate for Rochester Gas and Electric Corporation. The Company's test year expenditures for Conservation alone ($258,524) exceed the lower end of the range ($115,911) and would exhaust all but $31,253 of the higher end of the range ($289,777). The test period advertising expenditures for only Conservation and Safety ($108,788) total $367,312, or $77,535 more than the higher end of the range would allow. Yet all of the areas which I have discussed are essential, and a necessary cost to Rochester Gas and Electric Corporation of doing business.

Appendix N-4

The Company needs to have, at the very least, all of its test period advertising expenses included for rate making purposes in these proceedings. We have no other source of revenue except through the rates which we charge our customers. Absent rates which reflect these costs we will simply lack the ability to communicate with our customers.

Q. At the hearing held on March 17, 1977 Staff Counsel requested that the Company submit "an estimate of the dollars included in the test year that stemmed from what that policy statement described as

SILVESTRONE [2142]

'political advertising', and the dollars included in the test year that stem from the prohibited type of bill insert advertisement". Would you please respond to that request?

A. The question regarding the bill inserts is relatively easy to answer. Our review of our bill inserts discloses none which would fall within the proscription of the Commission's February 25, 1977 Policy Statement, regardless of whether or not that proscription is legal or proper.

The question regarding expenditures for advertising, which are included in test period expenses for rate-making purposes and which might fall within the Commission's description of "political advertising" is somewhat less clear, although I believe the answer is the same. The difficulty stems from the fact that some of our test period advertising does touch upon the subject of nuclear power. Included in the $180,491 advertising expense during the test period in the category which I have described as "Information—Company" are approximately $51,974 for advertising which is related to nuclear power. However, the overwhelming purpose and thrust of this advertising is to reassure our customers, not of something which we are advocating,

SILVESTRONE [2143]

but rather of the safety, reliability and economy of something which Rochester Gas and Electric Corporation already has: the Ginna nuclear plant. A good example of such advertising is Attachment E to Exhibit 45. Obviously, one could argue that this advertisement promotes nuclear power. However, its purpose and emphasis is to reassure and inform our customers regarding the safety of the Ginna Plant and our effort toward vigilance to maintain that safety.

The line between what is the advocacy or promotion of nuclear power, "designed to influence public opinion", on the one hand, and what is advertising which is either a report "on matters of interest to the public concerning the utility's service" or "explains and describes its activities", on the other hand, is perhaps not as clear in practice as might be considered ideal. We *have* a nuclear plant which is located in our service area and which is generating a large portion of the electrical energy which we deliver to our customers. Under such circumstances, and given the frequent media stories raising doubts and fears about nuclear power, we feel compelled to inform and reassure our customers about our nuclear plant. In fact, we know that our customers want such information. Thus, while a small portion of

SILVESTRONE [2144]

our test year advertising included references to or discussions of nuclear power, we believe it falls in the permitted category rather than that which the Commission sought to eliminate for rate-making purposes.

Q. If the Commission decided that such advertising does fall within the category of advertising "which seeks to sway opinion . . . on public policy disputes", what would the Company's position be as to the allowability of the $51,974 for rate making purposes.

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A. It is the managerial judgment of Rochester Gas and Electric Corporation that such expenditures are a necessary and proper business expense and that such expenditures should be allowed for purposes of setting rates. This management position is not limited to advertising on the subject of nuclear power. The Company feels very strongly on the issue of its right to advertise, not merely out of concern for its own corporate well-being and out of a concern for the protection of the investment made by its shareholders and bondholders, but more importantly out of a concern for the right of our customers to have us communicate with them.

It seems to us that there are two aspects of this customer right to have us communicate. In the first

place, on many subjects we are the experts. For example, nobody knows more about electric generation, transmission and distribution than an electric utility. It would be clearly improper to deprive the people in our service area of the opportunity to obtain the views of the expert on the issues related to that expertise. In the second place, if utilities are to be able to meet their obligations to provide adequate and safe service at the lowest reasonable cost, it is essential that they have maximum understanding on the part of their customers. The customer disaffection which would arise from a seemingly arrogant, silent utility or, worse, from unanswered misunderstandings of the function and operation of the utility, would soon translate into a higher cost of business and, in all probability, a lower quality of service.

The Company believes that, as a franchised public service business, it is obligated to keep its customers advised about what it is doing and why—about what its problems are and what solutions are being sought. A part of our advertising is directed toward meeting this obligation to inform. Rochester Gas and

Electric Corporation is convinced that informed customers are understanding customers; and when customers understand

SILVESTRONE [2146]

they are more accepting of the things which we must do; and greater customer acceptance translates into lower costs of doing business and, therefore lower rates. It is the managerial judgment of the Company that customer understanding and acceptance manifest themselves in such things as less vandalism, reduced collection costs, and less emotional opposition to facility siting. Further, as I have already indicated, we know there are many subjects on which our customers want information from us. Advertising is, we believe, far less expensive than the cost of the individual telephone conversations and correspondence which would be required to respond to inquiries if we did not advertise. Thus what the customer pays in advertising expense the customer saves in other expenses; in our judgment the saving exceeds the payment.

The other aspect of the customer right to have its utility communicate with it pertains to subjects or issues on which the utility has expertise—expertise acquired at ratepayer expense. For example, nobody knows better than the electric utility what the cost and impact of a nuclear moratorium would be. How many individuals or groups or entities are more knowledgeable on the subject of either nuclear safety or nuclear

SILVESTRONE [2147]

problems than the electric utility industry which has been operating nuclear plants for almost two decades? Similarly, who knows better the cost and supply impacts of our present environmental statutes and regulations than the utility which is subject to them?

Thus Rochester Gas and Electric Corporation believes very strongly that its advertising expenses, unless shown to be clearly

excessive which they are not, are necessary costs of doing business, whether on nuclear power or not, and are proper expenses for rate making purposes.

Q. At the March 17 hearing in these proceedings Mr. Slaughter indicated that he "would like to know by type of media, by type of message, . . . by frequency and . . . the approximate amount of expense" for the Company's advertising. Would you please respond to that request?

A. Our records are not routinely kept in a manner which permits a very complete response to Mr. Slaughter's request without expending a great deal of time to compile it. However, I have already testified regarding our expenditures for various categories of advertising. It would be extremely difficult to refine those costs by media.

I can indicate the following data regarding our

SILVESTRONE [2148]

media usage. For our TV spots we use the three stations, in Rochester; we use both 30-second and 60-second spots. For our radio spots we used seven stations in Rochester and one station each in Auburn, Canandaigua, Newark and Wellsville; we use 10-second, 30-second, and 60-second radio spots. For our newspaper advertisements we used 44 newspapers throughout our service area. In 1976 we ran a total of 558 TV spots, 1,838 radio spots, and 714 newspaper advertisements. Of course, included in these numbers are many spots or advertisements which were repeated many times and which ran on many stations or in many newspapers. It would take a great deal of time and effort to compile data on the frequency with which each different spot or advertisement was run on TV, on radio and in newspapers.

Q. You have mentioned that the Company frequently repeats the same advertisement. Why is that?

A. There are two aspects of the question of repetition. First, there is repetition by running the same advertisement or spot once in each of several different newspapers or on each of several different stations. The reason for this is fairly obvious; different newspapers and stations have different readers and

SILVESTRONE [2149]

audiences, and cover different parts of our service area. We are trying to reach all of our customers with our messages.

The second aspect of repeating advertisements is the running of the same ad more than once in the same newspaper or on the same station. The reasons for this type of repetition have been shown in various studies. Primary is the fact that people forget fairly quickly, and repetition tends to prolong the retention of the message. Second, not everyone is exposed to an ad each time it is run; people are too busy to read the paper one day but not another, or are away, or several other reasons. Third, different people are receptive to an ad at different times; today an individual may not care about conservation; but tomorrow he or she may. All of these factors indicate the need for repetition in order to have effective communication.

Q. Why does Rochester Gas and Electric Corporation utilize paid advertising to communicate with its customers rather than rely on news releases to the media?

A. In a sense that question might better be asked of representatives of the media. Our experience with relying on news releases has convinced us that it is not a feasible substitute. Often the release is

SILVESTRONE [2150]

ignored, and rarely is it used as submitted. For the utility, reliance upon paid advertising in order to communicate its

message is simply a necessity. The utility does not resort to "creative news" tactics—it does not disrupt meetings, stage sit-ins, conduct demonstrations, or deliberately violate the law. It is often in the position of responding to an earlier news item when the media have moved on to other matters. Also, there is usually little or nothing sensational about the message which the utility wants to communicate. It is not "news". It is simply a fact of life that utilities have found it necessary to use paid advertising in order to assure that their message is communicated intact to their constituents.

SILVESTRONE [2151]

MR. HUBER: The witness is tendered.

MS. HAMMOND: Your Honor, I would make a motion at this point that this testimony in its entirety be stricken from the record because it is improper rebuttal. It is not rebuttal at all and it is not responsive to the point that Staff made in its own direct case. It is not responsive to the advertising policy statement by the Commission, and it is simply a re-arguing of that case and perhaps it would be appropriate material to be raised in a re-hearing, but I do not believe this is proper rebuttal testimony.

JUDGE MOYNIHAN: I will overrule your objection.

MS. HAMMOND: I have no questions.

MR. AXELROD: No questions from the Consumer Protection Board.

JUDGE MOYNIHAN: Thank you, Mr. Silvestrone. You are excused.

Appendix O
EXHIBITS

Appendix O-1
EXHIBIT 4A

Rochester Gas and Electric Corporation

Electric Department
Customer Service and Sales Promotion Expenses

Twelve Months Ended
December 31, 1973, 1974, 1975, 1976
and June 30, 1976

Acct. No.		12 Months Ended December 31, 1973	December 31, 1974	December 31, 1975	June 30, 1976	December 31, 1976
	Customer Service Expenses					
909	Supervision		$ 211,615	$ 227,574	$ 241,941	$ 252,016
910	Customer Assistance Expenses		711,712	698,822	730,058	775,248
911	Informational Advertising Expenses		519,797	450,866	469,555	543,952
912	Miscellaneous Customer Service Expenses		151,167	147,773	157,040	154,541
913	Rents		4,408	3,705	4,010	2,920
	Total Customer Services		$1,598,699	$1,528,740	$1,602,604	$1,728,677
	Sales Promotion Expenses					
915	Supervision	$ 210,740	$ 6,168	$ 7,916	$ 3,493	$ 91
916	Demonstrating and Selling Expenses	812,356	84,861	61,834	52,685	41,744
917	Promotional Advertising Expenses	58,667	30,176	21,969	22,405	22,140
918	Miscellaneous Sales Promotion Expenses	154,753	1,139	257	261	83
919	Rents	3,303	22	—	—	—
	Total Sales Promotion	$1,239,819	$ 122,366	$ 91,976	$ 78,844	$ 64,058
	Total Customer Services and Sales Promotion Expenses	$1,239,819	$1,721,065	$1,620,716	$1,681,448	$1,792,735

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Exhibit 4A
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Rochester Gas and Electric Corporation

Electric Department
Administrative and General Expenses

Twelve Months Ended
December 31, 1973, 1974, 1975, 1976
and June 30, 1976

Acct. No.		12 Months Ended December 31, 1973	December 31, 1974	December 31, 1975	June 30, 1976	December 31, 1976
	Operation					
920	Administrative and General Salaries	$ 2,205,967	$ 2,398,355	$ 2,689,042	$ 2,847,078	$ 2,971,381
921	Office Supplies and Expenses	573,472	660,218	687,705	764,183	813,957
923	Outside Services Employed	396,252	437,659	550,587	552,323	514,030
924	Property Insurance	824,959	829,252	863,529	915,518	905,519
925	Injuries and Damages	237,086	213,629	255,947	325,840	413,925
926.1	Employee Pensions	3,253,896	3,098,366	3,702,034	4,084,576	4,476,262
926.2	Employee Welfare Expenses	1,130,868	1,156,272	1,341,057	1,583,788	1,760,714
926.3	Pension and Welfare Administration	35,584	42,473	41,994	45,048	46,888
928	Regulatory Commission Expenses	348,056	369,540	354,697	341,242	675,089
929	Duplicate Charges, Credit	(9,465)	(7,843)	(7,469)	(8,860)	(9,798)
930	Miscellaneous General Expenses	1,491,992	1,239,452	1,526,075	1,786,836	1,687,620
931.1	General Rents	43,181	58,914	66,588	66,451	72,505
931.2	Expenses of Data Processing Equipment	38,198	27,940	43,386	80,401	108,608
	Total	10,570,046	10,524,227	12,115,172	13,384,424	14,436,700
	Maintenance					
932.1	Structures	618,303	616,491	621,693	674,231	756,429
932.2	Office Furniture and Equipment	31,999	36,154	42,770	46,293	59,661
932.3	Communication Equipment	54,632	50,713	56,379	61,528	67,352
932.4	Miscellaneous Equipment	4,618	17,167	25,544	37,093	36,976
	Total	709,552	720,525	746,386	819,145	920,418
	Total Administrative and General	$11,279,598	$11,244,752	$12,861,558	$14,203,569	$15,357,118

Appendix O-2
EXHIBIT 5A

Rochester Gas and Electric Corporation

Gas Department
Customer Service and Sales Promotion Expenses

Twelve Months Ended
December 31, 1973, 1974, 1975, 1976
and June 30, 1976

Acct. No.		12 Months Ended December 31, 1973	1974	1975	June 30, 1976	December 31, 1976
	Customer Service Expenses					
909	Supervision		$108,629	$118,789	$114,861	$110,693
910	Customer Assistance Expenses		268,483	252,691	217,933	196,631
911	Informational Advertising Expenses		8,774	69,616	128,255	141,895
912	Miscellaneous Customer Service Expenses		79,724	90,950	83,178	72,997
913	Rents		1,651	1,596	1,795	1,335
	Total Customer Services Expenses		$467,261	$533,642	$546,022	$523,551
	Sales Promotion Expenses					
915	Supervision	$ 97,526	$ 66	$ 78	$ 1	$ 28
916	Demonstrating and Selling Expenses	252,353	10,676	7,524	4,211	977
917	Promotional Advertising Expenses	3,405	55	–	1,400	40
918	Miscellaneous Sales Promotion Expenses	97,813	238	143	43	–
919	Rents	4,171	–	–	–	–
	Total Sales Promotion Expenses	$455,268	$ 11,035	$ 7,745	$ 5,655	$ 1,045
	Total Customer Services and Sales Promotion Expenses	$455,268	$478,296	$541,387	$551,677	$524,596

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Exhibit 5A
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Rochester Gas and Electric Corporation

Gas Department
Administrative and General Expenses

Twelve Months Ended
December 31, 1973, 1974, 1975, 1976
and June 30, 1976

Acct. No.		12 Months Ended December 31, 1973	December 31, 1974	December 31, 1975	June 30, 1976	December 31, 1976
	Operation					
920	Administrative and General Salaries	$1,437,740	$1,549,445	$1,716,482	$1,816,481	$1,880,707
921	Office Supplies and Expenses	351,029	402,744	414,955	456,549	492,329
923	Outside Services Employed	226,449	276,412	379,534	352,169	350,448
924	Property Insurance	54,597	55,878	56,530	58,590	58,780
925	Injuries and Damages	177,585	167,757	211,030	258,147	297,091
926.1	Employee Pension	1,428,355	1,357,519	1,605,796	1,719,930	1,891,149
926.2	Employee Welfare Expenses	544,657	558,999	639,017	731,235	803,984
926.3	Pension and Welfare Administration	23,426	27,961	27,646	29,657	30,868
928	Regulatory Commission Expenses	165,626	174,461	166,697	164,703	232,652
930	Miscellaneous General Expenses	724,076	560,545	520,553	412,593	646,337
931.1	General Rents	26,642	33,340	37,471	35,890	39,264
931.2	Expenses of Data Processing Equipment	25,147	18,262	21,993	24,700	29,110
	Total	$5,185,329	$5,183,323	$5,807,704	$6,060,644	$6,752,719
	Maintenance					
932.1	Structures	$ 316,928	$ 323,566	$ 344,000	$ 373,722	$ 412,758
932.2	Office Furniture and Equipment	19,122	21,593	23,334	26,173	32,839
932.3	Communication Equipment	39,527	36,361	42,400	45,941	48,161
932.4	Miscellaneous Equipment	306	9,105	13,722	18,854	18,302
	Total	375,883	390,625	423,456	464,690	512,060
	Total Administrative and General	$5,561,212	$5,573,948	$6,231,160	$6,525,334	$7,264,779

ROCHESTER GAS AND ELECTRIC CORPORATION
DCF Cost of Common Equity
1965-1977

	Book Value Per Share*	Earnings Per Share	Dividends Per Share	Return On Book	Payout Ratio	Average Market Price*2	MBR	Growth From Retained Earnings	Dividend Yield	D/P+G
1965	$17.65	$2.04	$1.00	11.6%	49%	$37.06	210X	5.9%	2.7%	8.6%
1966	18.30	2.10	1.05	11.5	50	30.38	166	5.8	3.5	9.3
1967	18.95	2.24	1.10	11.8	49	28.50	150	6.0	3.9	9.9
1968	19.61	2.37	1.10	12.1	46	29.69	151	6.5	3.7	10.2
1969	20.31	2.45	1.15	12.1	47	28.50	140	6.4	4.0	10.2
1970	20.90	2.29	1.20	11.0	52	24.50	117	5.3	4.9	10.2
1971	21.29	2.08	1.20	9.8	58	24.88	117	4.0	4.8	8.8
1972	21.48	2.07	1.20	9.6	58	22.56	105	4.0	5.3	9.3
1973	21.74	2.27	1.22	10.4	54	20.03	92	4.8	6.1	10.9
1974	21.97	1.79	1.24	8.2	69	15.25	69	2.5	8.1	10.6
1975	21.76	2.05	1.26	9.4	61	14.25	65	3.7	8.8	12.5
1976	21.79	2.38	1.28	10.9	54	17.69	81	5.0	7.2	12.2
1977	22.05*1	2.38	1.28	10.8	54	18.69*3	85	5.0	6.8	11.8

* Average of beginning and year end book value.
*1 Year end 1976.
*2 High-Low price.
*3 Average price to 3/21/77.

Appendix O-3
EXHIBIT 25

No. 80-1152

IN THE

Supreme Court of the United States

October Term, 1980

ROCHESTER GAS AND ELECTRIC CORPORATION,
Appellant,

v.

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
Appellee.

ON APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

MOTION TO DISMISS APPEAL OR AFFIRM JUDGMENT BELOW

PETER H. SCHIFF
General Counsel

HOWARD J. READ
Assistant General Counsel

SIGRID J. HAMMOND
Staff Counsel

Public Service Commission
of the State of New York
Three Rockefeller Plaza
Albany, New York 12223
Tel. No. (518) 474-2510

Attorneys for Appellee,
Public Service Commission
of the State of New York

February 10, 1981

Batavia Times Publishing Co.
Batavia, N.Y. (716) 344-2800

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IN THE

Supreme Court of the United States

October Term, 1980

No. 80-1152

ROCHESTER GAS AND ELECTRIC CORPORATION,
Appellant,

v.

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
Appellee.

On Appeal From the Court of Appeals
of the State of New York

MOTION TO DISMISS APPEAL OR AFFIRM JUDGMENT BELOW

Appellee, pursuant to Rule 16 of the Rules of the Supreme Court of the United States, moves (1) that this appeal be dismissed on the ground that it does not present a substantial federal question or (2) that the judgment of the New York State Court of Appeals sought to be appealed from be affirmed.

Statement

This case involves an appeal from a determination (Appendix pp. 1a-2a)[1] of the Court of Appeals of the State of New York which upheld an order by appellee Public Service Commission of the State of New York (Commission) limiting the amount that may be included in rates chargeable to appellant Rochester Gas and Electric Corporation's (Rochester) ratepayers for institutional and informational advertising.

The Commission's order culminated its investigation of an application by Rochester for increased electric and gas revenues. The Commission, in a decision issued November 1, 1977 (Appendix pp. 42a-92a) granted Rochester $10 million in additional electric revenues and $2.5 million in additional gas revenues annually. In accordance with the usual policy, the rates authorized by the Commission were designed to yield the allowed rate of return during the first twelve months after the rates became effective.

As part of its rate determination, the Commission concluded that Rochester should be limited to an allowance of $^1/_{10}$ of one percent of gross revenues for institutional and informational advertising as prescribed by the Commission's Statement of Policy on Advertising and Promotional Practices of Public Utilities issued February 25, 1977 (Appendix pp. 173a-195a). Before issuing its Statement of Policy, the Commission had examined the institutional and informational advertising expenses of all New York State utilities. It concluded (Appendix pp. 184a-187a) that the advertising expenses were to some

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[1] References to Appendix _____ are to Appellant's Appendix to Jurisdictional Statement.

extent an inescapable cost of doing business but that ratepayers should not be forced to bear an unlimited amount of expenditures for this type of advertising. The Commission further found (Appendix p. 185a) that its staff spent far too much time examining expenses item-by-item to determine the amounts that should be includable in future rates and that its time should be employed in a more productive manner. Accordingly, the Commission announced its intention to allow a limited amount for institutional and informational advertising that would enable utilities to conduct advertising but would also be fair to the ratepayers (Appendix p. 186a):

> . . . On the basis of past practice, this allowance will, in all probability, range between $^1/_{10}$ and $^1/_{25}$ of one percent of operating revenues, in inverse relationship to the size of the companies. It will be determined individually for each company, in its next or pending rate case, [footnote omitted] on the basis of various other factors including size, geographical location, number of customers and costs of doing business in the area . .

The Commission in its opinion allowing increased rates for Rochester for the period starting November 1977 explained the application of its Statement of Policy to Rochester's advertising allowance (Appendix pp. 61a-63a):

> RG&E expended $755,082 during 1976 for advertising. This amount is well in excess of the range of reasonable advertising costs established in our Policy Statement on Advertising issued in February of this year. The lower and upper limits of that range for RG&E would be $122,200 and $308,000.

* * *

RG&E continues to argue for ratemaking recognition of the full amount of advertising expense that it incurred in 1976. It contends that the Policy Statement is unconstitutional and points to court decisions holding that managerial decisions are, in the absence of evidence to the contrary, presumed proper. RG&E fails to recognize, however, that it has the burden of proof in rate cases to establish that the expenses claimed are reasonable and representative of the level that will be incurred in the pertinent rate setting period. Except for a detailed description of how it spent $755,982 for advertising in 1976, RG&E has made no effort to prove that this level of expenditure is reasonable and necessary and representative of a reasonable amount of advertising for the period for which rates are being established. It is not enough to say, in effect, "this is what we spent and this is how we spent it." The company has an obligation and a burden to demonstrate why those amounts are reasonable, particularly in light of the fact that the company's advertising costs are well in excess of the guidelines set in our Policy Statement. RG&E has failed to satisfy its burden of proof and, therefore, we reject the company's contention that it is entitled to recover in rates set here the full amount of advertising expense it incurred in 1976.

It remains to be answered where within our guideline limits RG&E's allowance for advertising expense should be set. Staff argues for the lower limit but there is nothing to suggest that this is a proper result. In view of the company's extensive conservation and safety advertising programs, we will allow the upper limit of the range set in our guidelines even though RG&E's size and compact territory would argue for an amount closer to the middle of the range. The company also claimed a 6% per year allowance to cover escalation in advertising

> expenses from 1976. No inflation factor will be applied because we have selected an amount which we find to be a reasonable level of advertising expenses for the ratemaking year 1978.

The Commission reaffirmed its position on Rochester's advertising expenses when denying the company's petition for reconsideration (Appendix pp. 31a-41a). In response to Rochester's contention that a "presumption of regularity" existed with respect to historical expenses which had not been challenged, the Commission stated (Appendix, pp. 36a-37a):

> RG&E first complains that we have ignored the presumption of regularity which requires at least a *prima facie* rebuttal before a matter is put in issue and ignored what it describes as unchallenged evidence of the propriety of its test year level of advertising expense. We observed in our decision that the company's test year advertising costs were well in excess of the guideline limits set in our Policy Statement. Although RG&E repeatedly refers to the absence of evidence tending to rebut the propriety of its advertising expenditures, it chooses to ignore the testimony of two witnesses of intervenor Genesee Valley People's Power Coalition (GVPPC) that questions the need for the level of informational and institutional advertising incurred by the company,[1] as well as staff witness Rosenstrauch's adjustment deleting advertising costs in excess of one-twenty-fifth of 1% of operating revenues. Of course, the reason why staff did not examine the advertising expenditures of RG&E to ferret out specific disallowable programs and costs and why the particular items discussed by GVPPC were not evaluated was our announced decision to forego such

[1] One GVPPC witness questioned the need for specific RG&E advertising programs and advertisements as well as the overall level of advertising expenditures incurred by the company.

> unproductive, time consuming and costly review and to proceed by broadening the definition of the kinds of advertising we would allow without question, but to determine in each rate proceeding, a percentage of revenues constituting the maximum we would allow.

The Commission further discussed Rochester's failure to meet its burden of proof (Appendix p. 37a):

> RG&E also maintains that it satisfied its burden of proof as to the need for an advertising allowance equivalent to the amount it expended for that purpose in the test year. As we observed in our principal Opinion, however, RG&E's testimony on advertising is a litany of how and where it spent $755,982 on advertising in 1976 and concludes that an allowance within the Commission's Policy Statement range would be wholly inadequate. No effort was made to suggest why the test year level of expenditure was necessary and proper.

The Commission also rejected Rochester's argument that the Commission's limitation was an impermissible restriction on its freedom of speech (Appendix p. 37a):

> The company further contends that our decision interferes with its right to communicate with its customers and would require a reduction in desirable advertising programs. At the outset, it should be clearly understood that nothing in our Policy Statement or in our Opinion in this proceeding interferes with the company's right to communicate with its customers. Our action imposes a limit on the amount the company can recover from its ratepayers for that purpose; the company can spend more for advertising if it sees fit but the excess will be at the expense of the shareholders.

After its petition for rehearing was denied, Rochester commenced a proceeding pursuant to Article 78 of the New York Civil Practice Law and Rules to review the Commission's determination. The litigation concluded in a determination by the New York Court of Appeals affirming an order of the Appellate Division, Third Department upholding the Commission's decision (Appendix pp. 1a-2a).

In its memorandum-decision, the Court of Appeals considered Rochester's argument that it has a First Amendment right to have its ratepayers "... bear the expense of certain informational advertising which the Public Service Commission has found unnecessary to the functioning of utility services ..." The Court recognized that Rochester's expressional activity is entitled to First Amendment Protection citing this Court's decision in *Central Hudson Gas and Electric Corporation* v. *Public Service Commission*, _____ U.S. _____ (June 20, 1980). The Court of Appeals, however, rejected Rochester's First Amendment contention stating (Appendix pp. 1a-2a):

> ... But the Public Service Commission in this case has imposed no restraint, direct or indirect, upon petitioner's advertising or communications. Instead, the Commission has merely refused to include a portion of petitioner's information advertising as an allowable expense, and determined that such costs should be paid by the utility share-holders. ...

> It is an accepted principle that, although the Constitution may provide a citizen the right to engage in a certain activity free of governmental restrictions, it places no general corresponding duty upon government to ensure the availability of all resources necessary to realize that freedom (see, e.g., *Harris* v. *McRae*, 448 US _____, 48 USLW 4941, 4946-4947; *Norwood* v. *Harrison*, 413 US 455, 462). Thus, the Public Service Commission is not obliged to allow the utility to charge ratepayers for all communications which the utility may choose to make. On this view of the case, it is unnecessary to address the contention, made by the Commission, that inclusion of the entire cost of informational advertising as an allowable expense would violate the first amendment rights of ratepayers (cf *Abood* v. *Detroit Board of Education*, 431 US 209).

The Court of Appeals also rejected Rochester's challenge to the lack of evidentiary basis for the Commission's decision stating (Appendix p. 2a): ". . . [i]t cannot be said that this ruling is arbitrary, capricious or unsupported by substantial evidence [citation omitted]."

Rochester thereafter brought this appeal.

ARGUMENT

I. The Commission's decision is consistent with Rochester's freedom of speech.

Rochester contends (Jurisdictional Statement pp. 10-25) that the Commission's refusal to allow the utility to collect in future rates an amount equal to that spent in the past for institutional and informational advertising infringes on its right of free speech. Not only is the New York Court of Appeal's decision to the contrary correct, but Rochester also fails to raise a substantial constitutional claim.

The Commission's determination relates solely to how much money Rochester can charge its ratepayers for institutional and informational advertising. In the words of the Court of Appeals, the advertising in question is (Appendix p. 1a) "... unnecessary to furnishing of utility services ..." The advertising is under the control of utility management which may elect to spend as much as it desires or advertise in any manner it pleases. Here, there is no restriction on communication by the utility but merely an exercise of the Commission's ratemaking powers to assure that the ratepayers do not pay unnecessary or unreasonably high expenses for utility institutional and informational advertising.[2] The Commission, of course, has the authority and obligation under state law to allow only such rates as are just and reasonable (New York Public Service Law §66).

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[2] This case does not involve a prohibition or restriction on advertising as was the case in *Central Hudson Gas and Electric Corporation* v. *Public Service Commission*, _____ U.S. _____ (June 20, 1980) or *Consolidated Edison Company* v. *Public Service Commission*, _____ U.S. _____ (June 20, 1980).

The Commission's Statement of Policy (Appendix pp. 184a-187a) discusses the reasons why ratepayers should not be required to support unlimited amounts of institutional and informational advertising. While some of the advertising is obviously beneficial to consumers (*i.e.*, conservation measures, notification of emergency procedures, safety advice, etc.), there is a large middle ground of advertising that is neither clearly beneficial to consumers nor clearly political.[3] The middle ground consists, *inter alia*, of image polishing and attempts to create good will in the community it serves.

The Commission found (Appendix p. 185a) that it would be unproductive for parties in rate proceedings to examine and classify advertising voucher-by-voucher. Endless controversies would develop over relatively small dollar amounts. For ratemaking purposes the Commission concluded that the most practical way to proceed was to allow a pool of dollars to fund institutional and informational advertising. The application of the formula to the amount allowed Rochester is discussed in Point II.

Rochester attempts to take the Commission's ratemaking approach and elevate it to the level of a constitutional controversy. The simple truth is, however, that there is no authority to support Rochester's contention that a limitation on rates chargeable to utility customers violates its right to free speech.

Rochester concedes (Jurisdictional Statement p. 14) that "... the commission may limit its rate allowance for communication expenditures ..." but argues that this is a limitation on Rochester's free speech and therefore stan-

[3] No New York State utility is challenging the Commission's determination that the ratepayers should not pay for funding political advertising.

dards dictated by the First Amendment must be followed.[4] Rochester also appears to agree (Jurisdictional Statement p. 16) with the decision of the Court of Appeals (Appendix p. 2a) that even though the Constitution affords the right to engage in an activity, there is "... no general corresponding duty upon government to ensure the availability of all resources necessary to realize that freedom (see *e.g., Harris* v. *McRae,* 448 US _____, 48 USLW 4941, 4946-4947; *Norwood* v. *Harrison,* 413 US 455, 462) ...."

Rochester's sole rejoinder to that established principle is that the Court of Appeals failed to distinguish between affirmatively providing the resources and denying the opportunity to earn the resources. The purported distinction has no foundation in the law nor does it make sense, particularly in the context of utility ratemaking.

If the Commission had acceded to Rochester's request and allowed rates for its advertising program it would have forced the ratepayers (unless they chose not to use electricity or natural gas) to pay for the advertising in their rates. As the Court of Appeals observed, the result is no different from forcing taxpayers to fund abortions so that those who cannot afford them are not deprived of their rights (*Harris* v. *McRae, supra*). On the other hand, Rochester has not been deprived of the opportunity to engage in advertising and earn a fair return on its shareholders' investment. Advertising expenditures are within the discretion of management. Surely, if the utility spends more for image polishing than is allowed in rates, the shareholders may be forced to fund the program. But

[4] Rochester fails to explain how the Commission would have any authority at all to limit advertising costs to be paid for by ratepayers if this limitation is indeed one on free speech.

why should they not, if the advertising program is in excess of that found by the Commission to be beneficial to the utility's ratepayers who must pay the bills?[5]

A limitation on advertising expenses to be allowed in rates is no more a limitation on speech than any governmental restriction or program that lowers a company's earnings. Clearly, every tax could be subject to challenge on First Amendment grounds with the argument that the tax denied the company the opportunity to earn the resources needed to fund an advertising program.[6]

The Commission has done nothing more than require that any expenditures over the allowance be accounted for as "below-the-line" expenditures—not chargeable to the ratepayers. The constitutionality of treating advertising expenses as a below-the-line expense was litigated over a decade ago in *Southwestern Electric Power Co.* v. *F.P.C.*, 304 F.2d 29 (CA5), *certiorari denied sub nom. Alabama Power Co.* v. *F.P.C.*, 371 U.S. 924 (1962). In that case the United States Court of Appeals for the Fifth Circuit upheld a determination by the Federal Power Commission that expenses of advertising in favor of private power and in opposition to public power were

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[5] This Court has rejected the argument that persons can be compelled to subsidize the dissemination of views by others. *See, Abood* v. *Detroit Board of Education*, 431 U.S. 209 (1977), finding that union members cannot be compelled to subsidize the dissemination of views unrelated to the union's duties as exclusive bargaining representative. In the instant case, the Commission was concerned with advertising in excess of that needed to fulfill Rochester's public utility functions, but which absent the Commission's determination would have been supported by the ratepayers.

[6] Rochester's citation (Jurisdictional Statement p. 17) of *Murdock* v. *Pennsylvania*, 319 U.S. 105 (1943), and *Grosjean* v. *American Press Co.*, 297 U.S. 233 (1936), relating to taxation of free speech, is misplaced. Here there is no tax on Rochester's exercise of First Amendment rights but merely a refusal by the Commission to require the ratepayers to fund excessive advertising expenses.

to be categorized as political and thus most likely paid for by the stockholders rather than the consumers. The utilities in that case contended that classifying the expenses as political and thereby rendering them, at least presumptively, non-recoverable in rates, infringed on the utilities' right of free speech. The Court rejected that argument, stating (304 F.2d at 47):

> . . . We are unable to find here any basis for an argument of this character. As we have noted, nothing in the order prohibits or restrains the petitioners from publishing or republishing these or any other similar advertisements. Their freedom of speech or freedom of action in this area are not in any manner limited. All that has occurred in this proceeding relating to keeping of accounts is to exercise the Commission's discretion as to where these expenditures should be entered and to do so in such manner as to indicate the views of the Commission that such expenditures should not be subsidized by the consumers who purchase the power; that those expenditures should be charged to an income account [*i.e.*, the stockholders].

This Court has recently dismissed an appeal for want of a substantial federal question in a case similar to that presented by Rochester. *Laclede Gas Co.* v. *P.S.C.*, 49 U.S.L.W. 3492 (January 12, 1981). In that case the Missouri Commission had disallowed actual test year advertising expenses of $204,691, finding that the money was related to goodwill advertising. The state court concluded, 600 S.W.2d 222, 228 (Mo. Ct. of Appeals, Western District 1980):

> The evidence herein does not support Laclede's argument that the P.S.C. undertook the management of the company or that such action by the P.S.C. violated any constitutional right of Laclede to the exercise of its right of free speech.

The court found that the Missouri Commission could properly exclude advertising expenses which are not justified operational costs from the rates chargeable by the utility. In the instant case, as in Laclede, there is also no substantial federal question since the Commission has not intruded on Rochester's First Amendment rights.[7]

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[7] Rochester also argues (Jurisdictional Statement pp. 20-25) that since its First Amendment rights have been limited, the Commission faces a greater burden in disallowing advertising expenses than in disallowing other items for ratemaking purposes. Since Rochester has failed to show a limitation on its freedom of speech, its argument, which assumes a limitation, is without relevance. Needless to say, however, the Commission did follow lawful procedures when setting Rochester's rates, a matter discussed in Point II.

II. The Commission followed lawful procedures in determining Rochester's allowance for advertising expenses.

As a second argument, Rochester contends (Jurisdictional Statement pp. 25-31) that this Court should find a substantial Constitutional question arising from the manner in which the Commission decided to allow the utility less that it desired to spend for advertising expenses. Rochester would have this Court examine the ratemaking process and second-guess the findings of both the New York State Supreme Court, Appellate Division, Third Department (Appendix pp. 19a-29a) and the New York State Court of Appeals (Appendix pp. 1a-2a) as to procedures required under the New York State Public Service Law before the Commission may determine rates for a public utility. Of course, both the Appellate Division (Appendix pp. 25a-29a) and the Court of Appeals (Appendix p. 2a) found that the Commission complied with lawful procedures for purposes of judicial review in the State of New York; *i.e.*, the Commission's decision was not reversible under Article 78 of the Civil Practice Law and Rules on the grounds that it was arbitrary, capricious, unreasonable or unsupported by substantial evidence.

Rochester criticizes the quality of the evidence in its rate case before the Commission and it contends that the Commission improperly relied upon its Statement of Policy as a means of limiting the expense allowance for institutional and informational advertising. Contrary to Rochester's assertions, the Commission properly relied on the evidence before it, including its Statement of Policy, in deriving the rate award to be supported by the company's customers.

At the outset, it is important to understand that the expenses at issue are not "actual" expenses in any sense of the word. The complaint here is not that Rochester was deprived of recouping in the future expenses or capital outlays that it had actually incurred in the past. For this reason, *West Ohio Gas* v. *Public Utilities Commission of Ohio,* 294 U.S. 63 (1935) and *Missouri ex rel. Southwestern Bell Telephone Company* v. *Public Service Commission,* 262 U.S. 276 (1923), cited by Rochester (Jurisdictional Statement pp. 27-28), are not in point. Nor is this a case where the allowance for the future is lower than what the company will be required to spend. The presumption of reasonableness of past expenditures relied upon by Rochester (Jurisdictional Statement p. 28) is therefore not in point because the Commission has determined, after an investigation of expenditures by all New York State utilities, that a reasonable expenditure level for institutional and informational advertising in the future is less than Rochester spent in the past.[8]

Despite the clear statement of the Commission cited by Rochester (Jurisdictional Statement p. 29) that the Commission would determine an allowance for each utility in subsequent rate proceedings, taking into account the expenditure levels set in its Statement of Policy,

[8] *Pacific Gas and Electric Co.* v. *Federal Power Commission,* 506 F.2d 33 (D.C. Cir. 1974), cited by Rochester (Jurisdictional Statement pp. 28-29), has no bearing on this case. There, the Court was dealing with the question of whether an *ex parte* statement of policy issued by the Federal Power Commission was exempt from the rulemaking requirements of the federal Administrative Procedure Act. In the case of appellee Commission's Statement of Policy, all parties including Rochester were invited to submit comments which were reviewed by the Commission before the Statement of Policy was issued. The Commission specifically announced its intention (Appendix p. 186a) to rely upon the Statement of Policy in subsequent rate proceedings.

Rochester's evidence submitted to the Commission (Appendix pp. 217a-238a) utterly failed to justify an expense in excess of the range set by the Commission. Rather, it was only as the Commission noted (Appendix p. 63a), a statement of "... this is what we spent and this is how we spent it ..."

The Commission acted entirely reasonably in applying its Statement of Policy limitations to the allowance for advertising expenses claimed by Rochester. Rochester's claim that the Commission's decision is unreasonable and is not based upon substantial evidence fails, as the courts below determined, to raise a valid issue of state law let alone a substantial federal question.

Conclusion

For the above reasons, this appeal should be dismissed or the decision of the New York State Court of Appeals summarily affirmed.

Respectfully submitted,

PETER H. SCHIFF
General Counsel

HOWARD J. READ
Assistant General Counsel

SIGRID J. HAMMOND
Staff Counsel

Public Service Commission
of the State of New York
Three Rockefeller Plaza
Albany, New York 12223

Attorneys for Appellee,
Public Service Commission
of the State of New York

February 10, 1981

No. 80-1152

In The

Supreme Court of the United States

OCTOBER TERM, 1980

ROCHESTER GAS AND ELECTRIC CORPORATION,
Appellant,

v.

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK,
Appellee.

On Appeal From The Court of Appeals Of The State Of New York

BRIEF OPPOSING MOTION TO DISMISS OR AFFIRM

RICHARD NEILL GEORGE
Nixon, Hargrave, Devans & Doyle
Lincoln First Tower
Rochester, New York 14603
Telephone: (716) 546-8000

Attorney for Appellant

Of Counsel
ROBERT L. DAILEADER, JR.

February, 1981

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BRIEF OPPOSING MOTION TO DISMISS OR AFFIRM

Rochester Gas and Electric Corporation ("Rochester") hereby replies to the Motion to Dismiss or Affirm of the Public Service Commission of the State of New York ("commission").

I

The Federal Questions Are Substantial

In addition to a substantial issue of due process, this appeal involves the *most* substantial of all federal questions: the right of free speech guaranteed by the First Amendment. This appeal raises the question of how First Amendment standards are to be integrated with rate regulation.

The question is one of wide-spread applicability. While of direct concern to every New York utility, utilities in other states are also subject to regulatory limitations upon their ability to communicate.[1] Nor are the principles raised in this appeal confined to state regulation or to electric, gas and telephone utilities; they are applicable to all governmental rate regulation.

The commission brushes aside the issues in this appeal as routine rate regulation. (Mot. p. 10.)[2] In so doing the commission implicitly asserts that it may deal with Rochester's right of speech in a manner identical to Rochester's property rights, contrary to the holdings of this Court. (J. S. pp. 20-21.) The commission makes it plain that it has not recognized, and, absent reversal by this Court, will not recognize the difference in rights.

This appeal raises a vital question: How are the standards required by the First Amendment to be accommodated within the rate-regulation process? (J.S. pp. 20-24.) It does not involve complex facts, or a difficult record. Rochester believes that the applicable principles have been expressed by this Court, but have not been applied in the circumstances raised in this appeal.

This appeal is different from *Laclede Gas Co. v. Public Service Comm'n*, ____U.S.____, 49 U.S.L.W. 3492 (No. 80-576, January 12, 1981). In *Laclede* the appellant suggested that disallowance of "goodwill" advertising expenses in setting rates is proscribed by the First Amendment. Rochester does *not* claim that the First Amendment prohibits the commission from limiting its

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[1] *E.g.: Pacific Northwest Bell Telephone Co. v. Davis*, ____ Or. App. ____, 608 P.2d 547 (1979); *Laclede Gas Co. v. Public Service Comm'n*, 600 S.W.2d 222 (Mo. Ct. of App., W. Dis't), *appeal dismissed*, ____ U.S. ____, 49 U.S.L.W. 3492 (1981). *Cf. Alabama Power Co. v. Alabama Public Service Comm'n.*, 359 So. 2d 776 (1978).

[2] References to appellee's Motion are cited herein as "Mot. p. ____"; references to the Jurisdictional Statement are cited as "J. S. p. ____"; and references to the Appendix to the Jurisdictional Statement are cited as "App. p. ____".

allowance for communication. Rochester agrees that the commission must be able to do so if rate regulation is to be effective.

Laclede did raise the reality that exclusion of communication expenses in setting rates is a limitation upon the right to communicate. Communication requires the expenditure of money, and the utility obtains money to pay expenses only to the extent provided for in the rates set by the regulatory body. (J.S. pp. 15-19.) But *Laclede* did not raise the question of how that reality was to be adapted to the important reality of rate regulation. The latter is raised precisely in this appeal. Upon the resolution of this question rests the reality of First Amendment rights for *all* entities subject to rate regulation.

The commission's refusal to comply with the due process requirement, that ratemaking determinations be based upon record evidence (J.S. pp. 25-31; point III, *infra*), raises a substantial federal question of critical importance to all such entities.

II

Free Speech Has Been Violated

The cornerstones of the commission's claim that its action is consistent with Rochester's freedom of speech are, first, an assertion that Rochester claims an absolute right to have unlimited amounts included in rates for communication, and, second, that denial of the means by which to exercise free speech is not a limitation of that right.

A. *"Unlimited amounts" are not at issue.*

The commission's apparent strategy is to convey the impression that only routine regulatory rejection of an attempt to impose excessive costs upon ratepayers is involved in this appeal. However, such is not the case.

The commission characterizes Rochester's position as contending that the First Amendment *requires* the commission to allow the amount of past communication expenditures in future rates (Mot. p. 9) or requires that the commission allow "unnecessary or unreasonably high expenses" (*ibid.*) or requires the commission to allow "unlimited amounts" (*id.* at 10). As stated *explicitly* in the Jurisdictional Statement (pp. 20, 23-24), Rochester claims no entitlement to an unlimited communication allowance and, on the contrary, specifically concedes that the First Amendment does not prevent the commission from limiting the amount allowed. But such a limit *is* a limitation upon Rochester's free speech and, as such, the commission must meet the standards of the First Amendment. (J. S. pp. 20-24).

The commission implies that it found some areas of Rochester's informational advertising program "unnecessary" (Mot. p. 9), to lack ratepayer benefit (*id.* at 10) or to consist of "image polishing" (*id.* at 10-11). However, the commission made no finding that any part of Rochester's communication program was unnecessary; both the commission staff (App. p. 205a) and the commission (*id.* at 35a-37a, 62a) disclaimed undertaking any such evaluation.[3] Similarly, there is no finding by the commission that any portion of the communications lack ratepayer benefit or consist of "image polishing."[4]

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[3]Further, the commission described the types of communication here at issue as "in the public interest and . . . a legitimate expense of doing business" and as "legitimate and indeed inescapable costs of doing business." (App. pp. 184a-185a.) In its brief to this Court in *Consolidated Edison Co. of New York, Inc. v. Public Service Comm'n*, ____U.S.____, 65 L.Ed.2d 319 (1980), the commission described the major part of these communications as an "obligation" of the utility (p. 24).

[4]Necessity or ratepayer benefit might be relevant to whether a limitation is *permissible*, but they do not affect the fact of limitation. And, to meet First Amendment standards, far more is required than merely implying lack of necessity or ratepayer benefit.

The commission infers that its approach to communication expenses is a reasonable short-cut to avoid evaluating Rochester's communication program. (Mot. p. 10.) This Court has held that neither reasonableness[5] nor regulatory expediency[6] will justify a limitation of speech. Further, Rochester has *not* suggested that the approach of a lump sum for communications, instead of item-by-item review, is impermissible. Rochester's complaint is that commission *implementation* of its approach failed to accept or meet its burden of showing that Rochester's historic level of expenditure exceeded the limits of reason.[7]

This Court has been explicit as to the standards for judging a limitation of First Amendment rights. The commission has not disputed its failure to meet those standards. That elementary failure raises a vital constitutional question of the extent and means by which those standards are applicable in rate regulation.

B. *Denial of the means to exercise a right is a denial of the right itself.*

The commission argues that its disallowance of Rochester's communication expenses is not a limitation upon Rochester's speech. Regardless of whether or not such a limitation is *permissible*, it is absurd to suggest that it is no limitation.

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[5]*Thomas v. Collins*, 323 U.S. 516, 530 (1945); *West Virginia State Board of Education v. Barnette*, 319 U.S. 624, 639 (1943).

[6]". . . the prospect of additional administrative inconvenience has not been thought to justify invasion of fundamental constitutional rights." *Carey v. Population Services International*, 431 U.S. 678, 691 (1977).

[7]In Rochester's immediately prior rate case, the commission described Rochester's expenditures for just *part* of these communications, which were equal to 0.2% of gross revenues (or *double* the amount allowed in this proceeding), as "modest" and "not unreasonable." *Rochester Gas and Electric Corp.*, 16 NYPSC 294, 309 (1976).

Rochester has dealt with this point quite explicitly (J. S. pp. 15-19), and will not repeat that discussion here.

The commission suggests there is no difference between a refusal to *give* a person the means to exercise a right and a refusal to permit a person to earn the means to exercise a right. It seems clear that there is a vast difference in the two situations and this Court has never equated them.

The commission suggests that to have allowed Rochester its communication expenses would have

> forced the ratepayers . . . to pay for the advertising in their rates . . . . the result is no different from forcing taxpayers to fund abortions so that those who cannot afford them are not deprived of their rights . . . . (Mot. p. 11.)

Public utilities are private corporations, albeit engaged in public service. *Munn v. Illinois*, 94 U.S. 113 (1877). They do not levy taxes, but charge for services. They do not collect payments from one customer to provide service to another. Ratepayers do not pay for poles or employees *or* advertising; ratepayers pay a just and reasonable charge for services provided.[8] *Board of Public Utility Comm'rs v. New York Telephone Co.*, 271 U.S. 23, 32 (1926). And, again, questions of excessiveness or forced payment would go not to the fact of limitation, but, at most, to the issue of whether that limitation was permissible under First Amendment standards.

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[8]Nor is there, as suggested by the commission (Mot. p. 12, n. 5), any issue of subsidization of speech by ratepayers. One might similarly argue that ratepayers "subsidize" Rochester's employees. *See also* J. S. p. 2, fn. 2.

Abood v. Detroit Board of Education, 431 U.S. 209 (1977) is irrelevant, quite apart from the lack of comparability between compulsory union dues and payments for service supplied. *Abood* held that it was "ideological activities *unrelated* to collective bargaining, for which such compulsion is prohibited." 431 U.S. 236 (emphasis added). Here all of the areas of communication involved are acknowledged by the commission to be service-related. (App. pp. 184a-185a, 200a-201a.)

The commission suggests (Mot. p. 12) that:

> A limitation on advertising expenses to be allowed in rates is no more a limitation on speech than any governmental restriction or program that lowers a company's earnings.

The commission has reinforced the point in our Jurisdictional Statement (p. 17). Here we are concerned with action directed specifically to speech — action intended and certain to limit the ability to communicate — not with programs, restrictions, or taxes of general application.

Any inclination to credit the commission's arguments should be disspelled by the misleading phraseology used in asserting (Mot. p. 12) identity of issues in this appeal and in *Southwestern Electric Power Co. v. Federal Power Comm'n*, 304 F.2d 29 (5th Cir.), *cert. denied sub nom. Alabama Power Co. v. Federal Power Comm'n*, 371 U.S. 924 (1962). Rochester responded to the same argument in the court below. *See* Appendix, hereto. *Southwestern* decided an issue of *accounting* jurisdiction and specifically *disclaimed* deciding the issue of allowability in rates of *political* advertising expenses. Here political advertising is not involved, and accounting is not at issue; here the issue is rate-making treatment.[9]

The commission's claim that its action does not limit Rochester's exercise of free speech is contrary to both logic and the decisions of this Court (J.S. pp. 15-19).

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[9]To be consistent with the commission's position *and* the facts, the first two sentences of this part of the commission's argument should have read (brackets for deleted words and italics for added words):

> The Commission has done nothing more than require that any expenditures over the allowance be [accounted for] *treated* as "below-the-line" expenditures — not chargeable to the ratepayers. The constitutionality of [treating] *accounting for* advertising expenses as a below-the-line expense was litigated over a decade ago . . . . (Mot. p. 12.)

The commission has reversed the key words.

C. *A policy statement does not satisfy the burden of a clear and compelling showing.*

The commission makes clear that, to sustain its limitation, it relies on its Statement of Policy. Both parties have dealt with evidentiary support in the due process point in their arguments. While we respond in point III to the matters raised on this issue by the commission, the difference in showings required by free speech and due process should not be overlooked.

Even if one could construe the record to provide substantial evidence, in no way can it be construed to provide the clear and compelling showing required by the First Amendment. The commission has converted a generalized announcement of anticipated policy into a binding substitute for evidence. The First Amendment has surely become frail if it is so easily evaded.

III

Due Process Has Been Denied

The commission suggests: "Rochester would have this Court examine the ratemaking process" on the issue at hand and reverse the findings of the courts below "as to procedures required under" New York law. (Mot. p. 15.) Rochester has not challenged procedures *required* by New York law; Rochester has challenged the action of the commission as complying with the requirements of neither free speech nor due process.

The commission confirms that it relies solely upon its Statement of Policy (Mot. pp. 10, 15-16) and, perhaps, the undisclosed "evidence" claimed to be the basis thereof (*id.* at 16). Rochester will not repeat its showing (J.S. pp. 28-29, 30-31) that such reliance is unlawful.

The commission, in a footnote, attempts to distinguish *Pacific Gas & Electric Co. v. Federal Power Comm'n*, 506 F.2d 33, 38-39

(D.C.Cir. 1974). (Mot. p. 16.) *Pacific Gas* is precisely on point: a general statement of policy is not a substitute for evidence.

The Statement of Policy does claim that, in response to the request for comments, "[o]ver 300 responses . . . were received" (App. p. 174a), but the substance thereof is neither disclosed nor discussed (*id.* at 184a-187a). Service of comments on other persons was not provided for and no opportunity for responsive comments was provided (*id.* at 196a).

Most important, in its Notice requesting comments, regarding the types of communication which comprise between 59 and 81 percent of the expenditures at issue in this appeal, the commission explicitly stated: "We do not solicit comments . . . ." (*Id.* at 200a.)

On its face, the Statement of Policy reflects only generalized policy concerns. (*Id.* at 184a-187a.) There is no indication of the claimed (Mot. p. 16) *investigation* of the *expenditures* by all utilities in general, and certainly no indication of any investigation of *Rochester's* particular needs or expenditures. The latter is the issue and the need for the commission to *specifically* address that issue was made acute in light of its completely opposite finding in the prior Rochester rate case (n.7, *supra*).

The Statement of Policy *itself* made it clear that, as to the *amount* allowed in its lump sum approach, it merely "announces what the agency seeks to establish as policy" (*Pacific Gas, supra*):

> On the basis of past practice, this allowance will, *in all probability,* range between 1/10 and 1/25 of one percent of operating revenues . . . . *It will be determined individually for each company, in its next or pending rate case* . . . . (App. p. 186a, emphasis added.)

Only *later,* in the rate case, did the commission convert this general policy statement into a substantive rule of law.

A general policy statement is neither evidence nor a substitute for evidence (J. S. pp. 28-29), and the undisclosed, non-record

"evidence" claimed to underlie that policy statement may not lawfully sustain the commission's determination (*id.* at 30-31).

If the commission's action is constitutional, then due process is no longer applicable to rate regulation.

CONCLUSION

If gross disregard of First Amendment rights and flagrant denial of due process do not raise substantial federal questions, then what does? The interrelationship of First Amendment standards with the ratemaking process should only need to be addressed once by this Court, but it is essential to both the regulated and the regulator that it be addressed.

The only summary disposition of this appeal which would be appropriate is reversal of the decision below.

Respectfully submitted,

RICHARD NEILL GEORGE
Nixon, Hargrave, Devans & Doyle
Lincoln First Tower
Rochester, New York 14603
Telephone: (716) 546-8000

Attorney for Appellant

Of Counsel
ROBERT L. DAILEADER, JR.

February, 1981

CERTIFICATE OF SERVICE

I hereby certify that on the 17th day of February, 1981, three copies of the foregoing Brief Opposing Motion to Dismiss or Affirm were served upon the Public Service Commission of the State of New York by mail by depositing the same in a United States post office, first class postage prepaid, addressed to Peter H. Schiff, Esq., General Counsel, Public Service Commission of the State of New York, Agency Building No. 3, The Governor Nelson A. Rockefeller Empire State Plaza, Albany, New York 12223. I further certify that all parties required to be served have been served.

Dated this 17th day of February, 1981, at Rochester, New York.

RICHARD NEILL GEORGE
Counsel for Appellant
Nixon, Hargrave, Devans & Doyle
Lincoln First Tower
Rochester, New York 14603
Telephone: (716) 546-8000

APPENDIX

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Portions of the Briefs to the New York Court of Appeals On the relevance of *Southwestern Electric Power Co. v. Federal Power Comm'n*, 304 F.2d 29 (5th Cir.), *cert. denied sub nom. Alabama Power Co. v. Federal Power Comm'n*, 371 U.S. 924 (1962)

From Brief of the Public Service Commission of the State of New York, pages 24-25:

The Commission has done nothing more than require that any expenditures over the allowance be accounted for as "below-the-line" expenditures — not chargeable to the ratepayers. The constitutionality of treating advertising expenses as a below-the-line expense was litigated over a decade ago in *Southwestern Electric Power Co. v. F.P.C.*, 304 F.2d 29 (CA5), *certiorari denied sub nom. Alabama Power Co. v. F.P.C.*, 371 U.S. 924 (1962). In that case the United States Court of Appeals for the Fifth Circuit upheld a determination by the Federal Power Commission that expenses of advertising in favor of private power and in opposition to public power were to be categorized as political and thus most likely paid for by the stockholders rather than the consumers. The utilities in that case contended that classifying the expenses as political and thereby rendering them, at least presumptively, non-recoverable in rates, infringed on the utilities' right of free speech. The Court rejected that argument, stating (304 F.2d at 47):

> . . . We are unable to find here any basis for an argument of this character. As we have noted, nothing in the order prohibits or restrains the petitioners from publishing or republishing these or any other similar advertisements. Their freedom of speech or freedom of action in this area are not in any manner limited. All that has occurred in this proceeding relating to keeping of accounts is to

> exercise the Commission's discretion as to where these expenditures should be entered and to do so in such manner as to indicate the views of the Commission that such expenditures should not be subsidized by the consumers who purchase the power; that those expenditures should be charged to an income account [*i.e.*, the stockholders].

From Reply Brief of Rochester Gas and Electric Corporation, pages 7-8:

Similarly, *Southwestern Electric* does not support the Commission. The issue — and the only issue — decided in that case was the *accounting* jurisdiction of the regulatory agency relative to *political* advertising. In the order being reviewed by the Court the Federal Power Commission had specifically stated:

> "Of course, the question of whether the rate payer or the shareholder shall ultimately pay these particular expenses must await rate proceedings under the Act, for an accounting classification matter of this kind does not involve determining the just and reasonable rates for the utility." 304 F.2d 38 (fn. 16).

Indeed, in the portion of the opinion quoted by the Commission (C.Br. 25) the Court, in rejecting the First Amendment arguments of the petitioners, held:

> All that occurred in this proceeding relating to keeping of accounts is to exercise the Commission's discretion as to where these expenditures should be entered .... 304 F.2d 47.

In this proceeding, not only are political expenditures not involved, but the issue is the opposite of that involved in *Southwestern Electric*. Contrary to the Commission's loose use of words the issue here does not involve the accounts in which the

communication expenses are to be entered;[7] here the issue is that which *Southwestern Electric* disclaimed deciding; whether the communication expense is to be paid for by the ratepayer. *Southwestern Electric* is no authority on that issue.

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[7]The Commission asserts:

> The Commission has done nothing more than require that any expenditures over the allowance be *accounted for* as "below-the-line" expenditures — not chargeable to rate-payers. C.Br. 24 (emphasis added).

In point of fact, under the Commission's Uniform Systems of Accounts the expenditures at issue are properly accounted for in Account Nos. 911, 917 and 930.1 (A. 269[*]), all of which are "above-the-line" accounts. *Cf.* 16 NYCRR, Chap. II, Subchap. F, Art. 1.

[*See App. p. 204a.]